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ONTARIO

LEGISLATIVE ASSEMBLY

1979

THE INSURANCE INDUSTRY
THIRD REPORT ON
GENERAL INSURANCE

THE SELECT COMMITTEE
ON
COMPANY LAW

Tabled in the Legislative Assembly
by

JAMES R. BREITHAUPT, Q.C., M.P.P.
CHAIRMAN

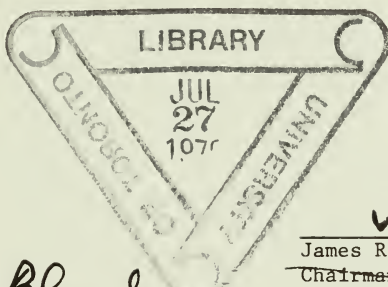
Third Session, 31st Parliament, 27 ELIZABETH II

LETTER OF SUBMISSION

TO: The Honourable John E. Stokes,
Speaker of the Legislative Assembly of the
Province of Ontario

Sir:

We, the undersigned members of the Committee appointed by the Legislative Assembly of the Province of Ontario on July 12, 1977, to enquire into and review the law relating to the business of insurance companies in the province, have now the honour to submit the attached Third Report on general insurance.



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PREFACE

The Select Committee on Company Law was reconstituted on May 25, 1976 under the following terms of reference:

“to continue the enquiry and review of the law affecting the Corporations in this Province as reported on by the Select Committee of this House appointed on June 22, 1965 and re-appointed on July 8, 1966, on July 23, 1968 and December 17, 1971 and to, in particular, enquire into and review the law relating to the business of insurance companies in the province including, but not restricted to:

- (a) the incorporation, licensing, regulation and supervision of insurers as joint stock companies, mutual corporations, fraternal societies, mutual benefit societies, exchanges, syndicates of underwriters and rating bureaus carrying on all classes of insurance business in this Province, mergers, amalgamations and reinsurance of liabilities, reporting to shareholders, policyholders and members, their solvency, liquidity and financial requirements, the purposes, scope and functions of their returns, reports, statistical gathering, and the basis for their rates and premiums;
- (b) automobile insurance contracts and, in particular, the provision of accident benefits, fire insurance, life insurance, accident and sickness and marine insurance contracts and generally insurance contracts in this Province;
- (c) the licensing, regulation and supervision of insurance agents, brokers and adjusters; and
- (d) the marketing of insurance in this Province.

And that the Select Committee have authority to sit during recesses and the interval between Sessions and have full power and authority to employ counsel and such other personnel as may be deemed advisable and to hold meetings and hearings in such places as the Committee may deem advisable and to call for persons, papers and things and to examine witnesses under oath, and the Assembly doth command and compel attendance before the said Select Committee of such persons and the production of such papers and things as the Committee may deem necessary for any of its proceedings and deliberations, for which the Honourable the Speaker may issue his warrant or warrants.”

In undertaking preliminary investigations into the business of insurance companies in the Province, the Committee quickly became aware of the breadth of this field of study. In order to segment the insurance industry into areas of enquiry that could be examined with reasonable care and thoroughness, it was agreed to focus first on the field of general insurance and to defer consideration of life insurance matters until a later date.

Priority within the non-life field was given to investigation of automobile insurance and the Committee issued two Reports on the topic of the automobile insurance system in the Province of Ontario.

The Committee's First Report on Automobile Insurance was submitted to the Legislative Assembly on March 28, 1977 by the Chairman, Mr. Vernon M. Singer, Q.C. The Second Report on Automobile Insurance was tabled in the following year on June 22, 1978 by the newly appointed Chairman, Mr. James R. Breithaupt, Q.C.

On July 5, 1978, the Committee was reconstituted to conduct enquiry into the remainder of the general insurance field, excluding automobile, and resumed its hearings with the appointment of fourteen members, as follows: Mr. Breithaupt (Chairman), Messrs. Blundy, Cunningham, Cureatz, Germa, Hodgson, Laughren, MacBeth, Reid, Renwick, Rotenberg, Smith, Van Horne and Yakabuski.

Since its most recent reconstitution, the Committee has held sessions on 40 days. There have been over 125 witnesses before the Committee to discuss the operations of the general insurance industry. A list of witnesses is set out in Appendix A and the Committee wishes to thank them all for their assistance and to express its indebtedness to all those who contributed to the over 100 exhibits, submissions, briefs and other documents received by the Committee.

The Committee wishes to extend its gratitude particularly to those persons who came to Toronto to appear before the Committee. Included were witnesses from outside the Province. The Committee greatly appreciates the participation of Mr. Tiit Pikksalu, Vice-President and Manager Canadian Operations, Allendale Mutual Insurance Company headquartered in Montreal; Mr. David L. Johnson, Vice-President, General Counsel and Secretary of Allendale Mutual Insurance Company, Massachusetts; Mr. John Drennan, Senior Actuary, Allstate Insurance Company in the United States; and Mr. Claire W. Miller, President, Harriott & Associates of Canada (1974) Limited. With the assistance of the many witnesses appearing before the Committee, members were able to obtain various perspectives on the operations of the general insurance industry.

In January 1979, a sub-committee of the Committee travelled to Milwaukee, Wisconsin to meet with representatives of the National Association of Insurance Commissioners in the United States. During the sessions in Milwaukee, members had the opportunity to meet with Mr. H. P. Hudson, Commissioner of Insurance, State of Indiana, President of the N.A.I.C.; Mr. Wesley J. Kinder, Insurance Commissioner, State of California, Chairman of the Executive Committee of N.A.I.C.; Mr. Harold R. Wilde, Jr., Commissioner of Insurance, State of Wisconsin, Chairman of the Competition Subcommittee; Mr. Richard L. Mathias, Director of Insurance, State of Illinois, Chairman of the Financial Condition, Examination and Reporting

Committee; Mr. Phillip O'Connor, Assistant to the Director of Insurance, State of Illinois; Mr. Robert E. Dineen, Consultant, N.A.I.C. Data Base, N.A.I.C. Central Office; and Mr. Jon S. Hanson, Executive Secretary and Director of Research, N.A.I.C. Central Office. The Committee is particularly thankful to Mr. Jon S. Hanson for his efforts in contacting and making the arrangements for these members of N.A.I.C. to meet with the sub-Committee.

The Committee also wishes to express its gratitude to those persons who appeared to express the consumer point of view, particularly in personal lines. Mrs. Barbara J. Shand, President of the Consumers' Association of Canada, Mr. William McLeod, Professor of Business Administration, Cambrian College in Sudbury, Mr. Edward Diebel, Alderman, City of North Bay, and Mr. R. M. Burnard, P.Eng., of Toronto are especially thanked for their time and effort in bringing their concerns before the Committee.

Appreciation is also extended to Mr. Norman Wright, retired Vice-President of Royal Insurance Canada, who attended the Committee's public hearings on behalf of the Independent Insurance Agents and Brokers of Ontario. Mr. Wright's attendance and responses from time to time to matters raised by members and witnesses were of great assistance to the Committee.

In addition to those who appeared before the Committee, our business consultants, Woods, Gordon & Co., contacted many other persons regarding their insurance concerns or asking for their assistance in the Committee's investigations. Several of these persons provided the Committee with information in briefs or letters which are included as part of the Exhibits. Woods, Gordon & Co. also interviewed a great many persons, all of whom were most co-operative in assisting with the research work. Valuable contacts included representatives of the Superintendent's Office, the Insurance Bureau of Canada, the Insurers' Advisory Organization, the Independent Insurance Agents and Brokers of Ontario, the Toronto Insurance Conference, the Ontario Risk and Insurance Management Society, individual insurance companies, adjusters, appraisers, various government departments and numerous other associations representing both industry and consumer groups.

Throughout its investigations into both automobile and general insurance, the Office of the Superintendent of Insurance of Ontario contributed generously toward assisting the Committee. The Committee is very much indebted to Mr. Murray A. Thompson, Q.C., Superintendent of Insurance of Ontario, Mr. Lear P. Wood, Director of Insurance Services, Mr. Ernest H. Miles, Director, The Motor Vehicle Accident Claims Fund, Mr. Martin T. Crutcher, Chief Examiner of Insurance Companies, Mr. Brian R. Newton, Senior Actuary and Mr. Michael Doherty, Registrar of Agents, Brokers and Adjusters.

The work of the Committee could not have been accomplished so effectively without the assistance of our consultants, Woods, Gordon & Co., who contributed greatly to the preparation of both the First and Second Reports on automobile insurance and to our Third Report. The consultants' research into the general insurance industry provided a background for the Committee's most recent investigations and their continual assistance during the hearings was most valuable. The Committee wish to express their thanks to Mr. R. Paul Boddy, C.A., Mr. Peter D. McKelvey, C.A., and Miss Ludmila Jagiellicz, M.B.A., representatives of Woods, Gordon & Co., for their assistance in the writing of this Report.

The Committee's special gratitude goes to Mrs. Frances Nokes, who has been the Clerk of the Select Committee since it was first appointed. She has been ably assisted by our secretary Mrs. Frances Davidson.

It is the Committee's intention to continue its studies under its terms of reference: to submit a subsequent Report on life insurance, which will also include a review of accident and sickness insurance, and to report on various other outstanding matters regarding the law affecting Corporations in this Province, including the subject of corporations without share capital.

PROVINCE OF ONTARIO
LEGISLATIVE ASSEMBLY
SELECT COMMITTEE ON COMPANY LAW

THE INSURANCE INDUSTRY
THIRD REPORT ON
GENERAL INSURANCE

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PART I

THE PUBLIC INTEREST AND
THE GENERAL INSURANCE SYSTEM

CHAPTER 1

The Need for a Government Presence in the General Insurance Industry

A. INTRODUCTION

The Select Committee on Company Law has conducted extensive hearings into all aspects of the general insurance system in the Province of Ontario. It has investigated the automobile insurance sector of the general insurance industry and has issued two Reports on the topic of the automobile insurance system in the Province. In addition, the Committee has now completed its investigation into the property and casualty sector of the general insurance industry and comments on its findings in this Third Report on General Insurance.

Study into all aspects of the general insurance system in the Province of Ontario has led the Committee to conclude that there is a need for a continuing government presence in the general insurance industry. The nature of the risk environment affecting both individuals and businesses and the nature of the insurance product are such that the Committee believes that there is a need for government supervision of the insurance system to safeguard the public interest.

As background to the Committee's conviction regarding a government presence, this chapter serves a threefold function. First, it outlines the Committee's observations regarding the risk environment, the essential nature of the insurance system and the nature of the insurance product. Secondly it comments on the responsibilities of the industry and the government in safeguarding the public interest. Thirdly, it introduces the structure of the remainder of the Report wherein the Committee will comment more specifically on improvements to the general insurance system in this Province and, in particular, to the property and casualty sector of the general insurance industry.

B. THE RISK ENVIRONMENT

Exposure to risk is inescapable. The risk environment is, however, continually changing and new ways to cope with risk must continually be developed. The Committee sees significant changes occurring at the present time in social and living patterns as well as continual economic and technological change and expansion—these factors are affecting exposures to risk and the demand for protection against risk.

For example, more densely populated centres and increasingly more complex and sophisticated technologies contribute to greater opportunity for a higher frequency of loss. In addition, rising property values, increasing liability costs and greater financial risks are reducing the ability of individuals and organizations to cope with the potential size of their own

losses. The increasing size of risk exposures is the result of numerous factors beyond the immediate control of the individual or business: price inflation, the uncertainty at the present time regarding the economy, heightened consumer consciousness, increased expectations leading to so-called “social inflation”, expanding definitions of liability and trends towards large loss settlements in many jurisdictions.

The Committee is led to believe that the risk environment in Ontario today is much more stable than in many other jurisdictions in North America and elsewhere in the world. While Ontario may differ from some other jurisdictions in terms of greater stability and control over amounts paid out on loss claims, a number of factors such as higher living costs and replacement costs and greater public expectations for compensation are placing a higher value on risk in the 1970's than in earlier decades. Growth in industrial investment and in new construction is also contributing to a greater value of private and business assets at risk. The pressures of a more complex social and living environment are further adding to risk through a higher incidence of insurance-related crime, such as theft, vandalism and arson—despite a record of lower incidence and better control of such crimes in this Province, relative to that in many other jurisdictions. In sum, the Committee views the risk environment to be increasingly more uncertain to the individual or organization in this Province.

C. THE ESSENTIAL NATURE OF INSURANCE

While society has developed a variety of responses aimed at coping with the risk environment, including government participation in public safety and loss prevention activities, the Committee views the insurance system as an essential, attendant mechanism for coping with those losses that will still inevitably occur. Insurance is the transfer of the risk of loss from individuals and organizations to a risk-sharing pool. Not only is there a compelling practical aspect to insurance, wherein the premiums of the many are used to pay the losses of the few, but there is also the aspect of necessity as insurance is required by most persons to cope with accidental losses that can be of substantial proportions. Both the essential and practical aspects of the insurance product create an almost universal demand for coverage in most situations of both small and large risks. The indispensable nature of insurance coverage is one of the reasons the Committee views the insurance contract as a product different from most others.

As a result of its investigations into property and casualty insurance, the Committee finds that destruction of a home or business premises likely is a substantial financial set-back to the individual who loses his investment in his dwelling or business or loses his job because his employer is unable to resume operations. The consequences of such losses can also easily spread throughout the community. This implies a social need for protection through insurance as well as an individual need.

Similarly, the insurance system is necessary for the process of risk-taking. Without the capability of insuring risks, it is unlikely that many major new investments would be made, because they represent an intolerable risk to the financial assets of the business firm. Likewise individual investments in homes and cars might be curtailed if insurance were unavailable to protect the investment both for the owner and the credit lender. Again, a reduction in risk-taking would have social consequences, for example in terms of the standard of living, as well as individual consequences.

In the automobile field, the Committee found that insurance was essential to cover losses resulting from bodily injury and from liability for property damage. The need for insurance was most apparent in protecting third parties involved in an accident. Accordingly, compulsory automobile insurance was recommended in order to protect the victims of automobile accidents.¹ The Committee is pleased to note that the government has accepted this principle.

When coverage is made compulsory, government supervision over the insurance industry is generally considered to be unavoidable. However, a need for objective supervision over the automobile insurance process has long been established, even without consideration being given to the compulsory aspect. Auto insurance, even when not compulsory, is considered to be essential to the driving public. That is, most motor vehicle owners individually perceive insurance to be essential to allow them to engage in the activity of driving, without the fear of drastic financial consequences in the event of an accident. Therefore, for most motor vehicle owners, automobile insurance does not need to be sold; it sells itself. As a result, the consumer is likely to want some assurance that the insurance product will serve him well.

Such is also the case in personal and commercial lines of property and casualty insurance, where insurance is necessary to protect an individual's shelter needs and it is a necessity in promoting risk-taking by protecting business activity from fortuitous losses and disruptions. Accordingly, the essential nature of property and casualty insurance also appears to call for some form of objective supervision over the provision and availability of the insurance product to the consumer.

D. THE NATURE OF THE INSURANCE PRODUCT

Insurance differs from most other products in that it is an intangible product. The purchase of an insurance contract is a *promise* of protection and future compensation rather than an exchange for an immediately tangible good or service. The future settlement of a claim is in fact the major

1. Select Committee on Company Law, *The Insurance Industry—First Report on Automobile Insurance*, Province of Ontario Legislative Assembly, 1977, page 173.

part of what the policyholder buys when he pays his premium. Yet the consumer may be unable to evaluate the insurer's promises of future performance at the time of purchase. In particular, the consumer is unable to evaluate the financial position of the insurance company as an indication of the ability of the company to pay future claims. Protection of the consumer in this regard was assumed as a responsibility of the government as early as 1877 when the Inspector of Insurance Companies was entrusted with the responsibility to ensure that the statement of affairs of licenced companies showed the companies' ability to meet their liabilities prior to issuance or renewal of licences.

Furthermore, in order to make a sound purchase decision in regard to an intangible product, the consumer needs information and perhaps advice regarding the insurance carriers and the coverages competing for his premium dollar. Information is particularly necessary because there are both real and perceived product differences in the insurance marketplace. In addition, the consuming public is hampered in its ability to judge the existence of unfair pricing practices since the price determination process for insurance differs from that of other products. The price of insurance is based on future costs, which must be predicted, rather than on actual costs of production, which are the basic determinant of price for most other goods and services.

In sum, the difficulty of evaluating an intangible product and the possibility that comparative product and price information may not be in the best interests of individual companies, compound the consumer's ability to judge which insurance product satisfies his needs best. The consumer may therefore welcome objective assistance in evaluating the insurance product and the performance of the insurance system.

E. SAFEGUARDING THE PUBLIC INTEREST

As a result of both the individual and social need for insurance, the Committee maintains that the insurance system must operate in the public interest and that consumer needs and services must be emphasized. Three specific objectives to be met in acting in the public interest were identified by a former New York State Superintendent of Insurance as follows:

- “1. Insurance must be made available to all who want and need it.
2. The insurance product should be of high quality and reliability. To illustrate, contract provisions should be clear and fair; arbitrary cancellations should be prohibited; and consumers should be protected against insurer insolvencies.
3. Insurance prices should be as low as possible, not subject to large and sudden changes, and fair as among policyholder. They should also in-

crease, rather than decrease, the likelihood that the first two objectives will be achieved.”¹

The Committee has had a full opportunity during its enquiry into general insurance to talk to insurance companies, sales intermediaries, claims adjusters and insurance buyers in this Province and is convinced that the industry in general recognizes its responsibility in acting in the public interest. In the Second Report, the Committee noted that “representatives of the insurance industry in Ontario maintain that the Ontario marketplace is now competitive in nature and that it accordingly ensures the best possible deal for the consumer”.²

But the Committee believes that the consumer’s ability to judge whether the industry is meeting its public interest objectives is complicated by the nature of the product sold and the nature and purpose of the insurance system. As already indicated, insurance differs from most other products in that it is an intangible product, whose reliability, benefits and costs are not fully apparent at the time of purchase.

Problems in satisfying the public interest also arise in meeting the objective that the insurance product is made available to all at a fair price. This objective is necessary given the essential nature of many types of insurance coverage. However, the insurance system, if allowed to operate in a purely unsupervised manner, runs the danger that this objective may not be met and that marketing practices will develop which are generally against the interests of some part of the insurance buying public. For example, unregulated competition among insurers can result in undesirable market conditions, such as insolvency, restrictive policy language and unfavourable loss-adjusting practices. It may also produce monopolistic practices such as collective pricing or it may provide the freedom to set inadequate, excessive or unfairly discriminatory rate levels in order to achieve a particular market objective.

Performance of the insurance system in the above ways is clearly recognized to be against the public interest. However, short of perfect competition, the *potential* will always exist for the insurance system to perform in ways contrary to the public interest. It is therefore the Committee’s view that the importance of all lines of general insurance to the Ontario consumer and the Ontario economy dictates, at the least, the need for a government presence to *oversee* the industry in its conduct and responsibilities regarding the provision of the insurance product.

1. Richard E. Stewart, “Ritual and Reality in Insurance Regulation,” in S. L. Kimball and H. S. Denenberg (eds.), *Insurance, Government and Social Policy*, Richard D. Irwin, Homewood Ill., 1969, p. 25.
2. Select Committee on Company Law, *The Insurance Industry—Second Report on Automobile Insurance*, Province of Ontario Legislative Assembly, 1978, page 114.

F. RATIONALIZING THE GOVERNMENT PRESENCE

In Reports One and Two, in the context of automobile insurance only, the Committee previously discussed aspects of the government presence in the insurance industry including responsibilities of the Superintendent of Insurance, rate regulation, solvency and licencing. It also examined the question of government ownership and, after weighing the various characteristics of the government automobile insurance systems, concluded that "Ontario can be better served under a system of automobile insurance operated within the private sector than by the adoption of a government automobile insurance system".¹

While reaffirming its confidence in the good faith and competence of the private automobile insurance industry, the Committee nevertheless concluded, in the light of its recommendations for compulsory automobile insurance, that the insurance system should be supervised carefully in the public interest. The Committee therefore made two series of recommendations in the first two Reports. The first series consisted of proposals to *guide* the insurance industry in improving the automobile insurance system. The second consisted of a number of recommendations that called for more direct government involvement in making certain explicit and fundamental changes in the insurance system. For example, the Committee recommended re-examination of the role of intermediaries in the insurance process, the enactment of legislation to introduce a compulsory programme of automobile insurance and the introduction of a no-fault system of compensation.

However, the Committee reserved final consideration of other aspects of the government's involvement in the insurance system until completion of its study into the remainder of the general insurance industry. As a result of the further study preceding this Third Report, the Committee has now had the opportunity to gain a broader perspective on the consumer's need for insurance and on the industry's ability to satisfy that need—not only in automobile lines but also in other property and casualty lines of general insurance. This broader perspective reinforces the Committee's conviction that there is a requirement, based on the nature of the insurance product and the risk environment, for some degree of continuing government supervision in the insurance industry. Corresponding to this conviction, the Committee's eventual objective in this Report is to address itself, in the context of the *entire* general insurance industry, to an overall *rationalization* of the government presence in the general insurance industry as it will function in the future in this Province.

While the Committee will continue its investigations into the business of insurance by studying the life insurance industry at a later date, the Committee is assured by the Superintendent that it is appropriate to con-

1. *Second Report on Automobile Insurance*, page 104.

sider the government presence in the general insurance industry separately from its consideration in regard to life insurance. The Insurance Act specifies that a licence shall not be granted to an insurer for the transaction of both fire and life insurance unless it maintains separate and distinct accounts, funds and securities in respect of its business of life insurance. In practice, general insurance differs significantly as a form of insurance business from the life insurance sector and the life insurance industry as presently operated is composed of an essentially separate set of companies with separate licencing requirements.

G. THE REMAINDER OF THE THIRD REPORT

Given the Committee's conclusion regarding the need for a rationalization of the government presence, the Committee intends, in this Third Report, to examine the general insurance industry as it operates today in property and casualty insurance lines. Part II of this Report provides necessary background information to the Committee's more specific considerations in the remainder of the Report.

Following in Part III, the Committee makes a number of broad basic observations on the general insurance industry as it operates in property and casualty lines and in automobile lines. The Committee then sets out in this Part some general guidelines on which its specific conclusions and recommendations in the remainder of the Report will be based. In addition in this Part, the Committee outlines its observations and recommendations on the surveillance of the effectiveness of competition in insurance markets and on the regulation of insurance company solvency.

Having completed its review of the general insurance industry in all its major component parts, the Committee recognized that similar broad concerns existed, in both automobile and property and casualty lines, regarding the industry's ability to satisfy consumers' needs and the government's activities in supervising industry operations. Therefore Parts IV to X of this Report provide the Committee's views regarding a number of basic concerns, both in general terms and with specific reference to property and casualty matters. The broad areas of concern considered in Parts IV to X correspond to the operations of the industry under the following headings:

a) Capacity

Part IV of this Report examines the ability of the industry in total and of companies individually to meet the demand in this Province for general lines of insurance. This Part also deals with the elements of a satisfactory operating environment to encourage industry growth, the responsibility for the efficient management of the industry and the mechanisms to maximize the utilization of the total capacity of the industry to provide access to meet consumer needs for insurance products.

b) Availability, Coverage and Cost

Part V of this Report is primarily concerned with the availability of property and casualty insurance at reasonable cost to those who want to buy it. The Committee finds that property and casualty lines of insurance present certain separate and distinct considerations that differ from the problems of cost and availability in automobile insurance lines. One difference is the matter of choice of coverage, which is limited in auto lines given that there is a standard automobile policy. The Committee addresses itself in this Part to the various issues associated with guaranteeing availability in personal lines and with the alternatives available to commercial insurance buyers in protecting business assets against losses. The government's role and activities in the matter of availability, cost and coverage form the conclusions to this Part.

c) Communications

Part VI of this Report examines the need for advice and counselling with respect to the insurance purchase and the consequent requirement for a high standard of communication between the insurance industry and the consumer. The Committee then comments on opportunities which can be utilized to improve communications.

d) Qualifications and Conduct

Part VII of this Report considers the qualifications and conduct of persons employed in the general insurance industry, from the point of view of knowledge about the insurance system and from the point of view of conduct in carrying out their responsibilities. The Committee then considers what role the government, through the Office of the Superintendent, should play in setting qualification standards, certifying persons as qualified, and monitoring their subsequent activities and conduct.

e) Loss Prevention

Part VIII of this Report examines the role of loss prevention in the insurance system. At the same time consideration is given to both public measures and individual efforts to control losses. The Committee then comments on the need for government responsibility and insurance industry contributions with regard to fire protection and suppression, education of the public, training, research, pre-loss inspection, implementation of loss control systems, investigation of losses and collection of data on losses.

f) Other Matters

A number of specific matters requiring separate consideration were brought to the Committee's attention during its hearings and are dealt with

in Part IX of this Report. Included as topics in this section are arbitration in claims disputes, liability insurance concerns, the surety bond market and comment on marine lines. The Committee attaches considerable importance to these matters despite their grouping in this Part of the Report.

g) Summary of Conclusions and Recommendations

Part X of this Report is a summary of the conclusions and recommendations that the Committee has reached, as set out in the preceding parts of this Report.

PART II

BACKGROUND TO STUDIES IN
THE GENERAL INSURANCE INDUSTRY

PART II

Background to Studies in the General Insurance Industry

INTRODUCTION TO PART II

In order to provide a perspective for the Committee's comments and recommendations in Parts III to X of this Report, the chapters of this Part provide extensive background information from the Committee's investigations into various aspects of the business of general insurance in this Province.

The introductory chapter to this Part describes the manner in which the Committee conducted its investigations into general insurance, commenting first on the Committee's completed study into the automobile insurance system and describing a number of improvements recently undertaken in the automobile insurance field. The remainder of the chapter outlines the Committee's approach to its investigations in the property and casualty sector of the general insurance industry.

The second chapter of this part then examines, in some detail, the organizational structure and financial results of the property and casualty insurance sector. The information in this chapter serves as a background to discussions later in this Report, mainly regarding insurance availability, cost and coverage. Comparisons with the automobile insurance sector provide a perspective on the overall structure and operations of the general insurance industry.

The remaining three chapters of this Part are concerned with a re-examination of the roles, responsibilities and interrelationships of the various participants in the general insurance industry, including the Superintendent of Insurance, as they relate to their functions and activities in *all* general insurance lines. These chapters provide essential background to the Committee's conclusions regarding the ability of the industry to serve consumer needs and the role to be assumed by the government in supervising the industry.

CHAPTER 2

Framework of Study into the General Insurance Industry

A. COMMENTS ON THE COMMITTEE'S STUDIES INTO AUTOMOBILE INSURANCE

1. Background

According to its terms of reference as set out in the Preface to this Report, the Select Committee on Company Law undertook to study, in some detail, the business of insurance companies in the Province. In order to segment the insurance industry into areas of enquiry that could be examined with reasonable care and thoroughness, it was agreed to focus first on the field of general insurance and to defer consideration of life insurance matters until a later date.

Priority within the general insurance field was given to the investigation of the automobile insurance sector and the Committee issued two Reports on the topic of the automobile insurance system in the Province of Ontario.

During its investigations into automobile insurance, the Committee had the opportunity to learn a great deal about the operations of general insurance companies, the role of intermediaries and other participants in the insurance industry, and the need for insurance as a method of protection for the public. Its studies permitted the Committee to make specific recommendations concerning the automobile insurance product and system. In addition, much of the insight gained into the structure of the automobile insurance industry served as a useful background for further study into other types of general insurance.

2. Initiatives to Improve the Automobile Insurance System

Since publication of the first two Reports, the Committee is pleased to note a number of initiatives undertaken by industry and government to improve the automobile insurance system.

In particular, the Committee welcomes the announcement of the government of its intention to introduce compulsory automobile insurance in the Province of Ontario by December 1, 1979.¹ The Committee is also advised that its recommendations in the Second Report² regarding a model system of compliance for enforcing compulsory insurance are under consideration in conjunction with the continuing review of the vehicle registration system in Ontario being undertaken by an Inter-Ministerial Committee

1. Select Committee on Company Law, *The Insurance Industry—First Report on Automobile Insurance*, Province of Ontario Legislative Assembly, 1977, page 173.

2. Select Committee on Company Law, *The Insurance Industry—Second Report on Automobile Insurance*, Province of Ontario Legislative Assembly, 1978, page 25.

composed of representatives of the Ministries of the Attorney General, Consumer and Commercial Relations, the Solicitor General and Transportation and Communications.

Furthermore, since publication of the First Report, the government enacted regulations effective July 1, 1978 which enriched the no-fault Accident Benefits or bodily injury coverage of the standard auto policy in accordance with the Committee's recommendations.¹ In addition, amendments to the Highway Traffic Act in November 1977 removed the concept of "gross" negligence from the Ontario law respecting automobile accidents, a further recommendation of the Committee.² Government announcement of intentions to expedite the judicial process in Ontario to settle cases with less delay as well as the recent judgments by the Supreme Court of Canada respecting pain and suffering awards are also welcomed by the Committee as beneficial steps that will help to control automobile insurance costs in the future.

In response to recommendations made in the First Report,³ the Ministry of Health has reached an agreement with Ontario insurance companies for recovery from liability insurers of medical costs incurred by the Ontario Hospital Insurance Plan. In lieu of O.H.I.P. subrogation on a case-by-case basis, insurers will pay to O.H.I.P. approximately two per cent of their annual motor vehicle third-party liability premiums, with payments to commence March 31, 1979. It is estimated that the Ministry under this agreement will save approximately \$750,000 per year in legal fees which, combined with savings in administrative and other costs, will total an annual \$1.4 million saving to the Ministry.⁴

The Committee is likewise pleased by the efforts of the insurance industry to improve its efficiency and competence in providing the automobile insurance product. In the area of claims settlement, as discussed in the Committee's First Report,⁵ the Insurance Bureau of Canada is continuing to sponsor expansion of the appraisal centre concept, with five new centres recently opened in the Metropolitan Toronto region.

In the area of rating, several companies have demonstrated initiative in reducing the premium burden for the young driver.⁶

The industry has also announced that it is ready to implement in 1979 a new inter-company pooling plan, called the Facility Association, to guarantee insurance availability to all drivers.⁷ The Facility Association will operate through designated servicing carriers who will process the policies

1. *First Report on Automobile Insurance*, page 71.

2. *Ibid.*, page 161.

3. *First Report on Automobile Insurance*, page 155.

4. *The Financial Post*, "Fixed auto accident payments would cut costs", February 3, 1979.

5. *First Report on Automobile Insurance*, page 142.

6. *First Report on Automobile Insurance*, page 123.

7. *Ibid.*, page 125.

and claims of substandard drivers on behalf of all subscribing insurers. The Facility Association will have its own rate manual, with premiums at a higher level than in the voluntary market.

The Committee sees the Facility Association as a sound commitment of the industry to ensuring availability of insurance to the drivers in this Province. However, the Committee in its Second Report concluded that a “take-all-comers” principle in marketing compulsory insurance would serve the driving public better than the facility association system.¹ The “take-all-comers” principle requires each insurance company to accept all applicants, using its own rate manual to quote premiums for each category of business it writes. Each company would then be permitted to pool 100% of the risk on any business it did not wish to retain, with the net costs of transferred risks being allocated among all insurers.

The Committee found it difficult to rationalize the concept of objective ratemaking based on common historical data with the concept of a company having two rate manuals applicable to drivers who for statistical purposes fall in the same category. As a result, it finds the Facility Association to be a less preferable alternative to the “take-all-comers” principle, for ensuring availability of insurance.

In addition, the Committee is informed that discussions are taking place between the industry and the Superintendent’s Office on the topic of improvements to the rating classification system. Corresponding to the Committee’s recommendations,² the discussions are centred on encouraging the industry to replace a rating classification based on age, sex and marital status, factors which are beyond an individual’s control, with a system keyed to driving experience, driving record and exposure in terms of miles driven annually.

A further important development following both the Committee’s examination of the automobile insurance distribution system³ and the insurance studies conducted in 1974 by Justice Douglas H. Carruthers for the Ministry of Consumer and Commercial Relations, is the government’s present initiative in introducing proposals for change to Part XIV of the Insurance Act regarding the licencing of agents and brokers.⁴ A major objective of the proposed changes is the clarification of the role of the sales intermediary in all the general lines of insurance, not only in automobile insurance. In addition, the Minister is eliciting at the present time the views of agents and brokers on their ability to undertake self-regulation and on how it will improve consumer service in this Province.

3. Further Matters Requiring Study

Many of the above initiatives to improve the automobile insurance

1. *Second Report on Automobile Insurance*, page 33.

2. *Second Report on Automobile Insurance*, page 153.

3. *First Report on Automobile Insurance*, page 215-6.

4. *Supra*, pages 69 to 71.

system have resulted from direct government involvement in the industry. This involvement and other forms of government supervision are channelled through the Office of the Superintendent of Insurance. In the Second Report on Automobile Insurance, the Committee examined the need for an ongoing government presence in the industry, specifically in rate regulation.¹ At the same time, it recommended that the government involve itself in making certain explicit and fundamental changes in the automobile insurance system—some of which have been implemented or are under discussion as illustrated above. However, the Committee reserved final consideration of the government's presence and the corresponding responsibilities and functions of the Superintendent's Office until completion of its study into the remainder of the general insurance field.

In particular, the Committee in its Second Report concluded that:²

- “The Committee must defer its final review of the responsibilities and functions of this Office (the Office of the Superintendent) until all questions regarding the insurance industry are raised.”
- “Included in the Committee's further study will be two further aspects which the Committee feels should be addressed in the context of the entire industry:
 - a) reinsurance and the part it plays in insurance costs; and
 - b) appropriate requirements for foreign and branch office reports to the Superintendent.”
- “An open competition system of rate regulation must not be considered out of the context of the overall topic of regulation and supervision of insurance companies; especially in relation to solvency and liquidity matters. The Committee therefore proposes to proceed, as it reviews other forms of general insurance, with a more detailed investigation of the entire topic in the course of its consideration of the role and function of the Superintendent's Office. This detailed investigation will include:
 - (a) An Open Competition System
 - The development of a suitable set of criteria for evaluating competition.
 - The establishment of the methods and mechanisms, including public reporting requirements, needed for regularly monitoring the existence and extent of competition in the Ontario insurance industry.
 - The advisability of legislating these new requirements or providing for them in regulation.

1. *Second Report on Automobile Insurance*, Chapter 11.

2. *Second Report on Automobile Insurance*, pages 118-119.

(b) Solvency and Liquidity

- Further consideration of the appropriateness of the solvency and liquidity rules as they pertain to the other-than-life insurance industry.
- Further consideration of the need to supplement or amend the present solvency and liquidity rules to make them more meaningful to present conditions.
- The advisability of legislating these rules or new requirements or providing for them in regulation.”

Consideration of these deferred topics is incorporated in the Committee’s current study into general insurance in addition to consideration of specific matters related to the various other lines of general insurance, excluding automobile. Accordingly, in approaching its current investigations, the Committee’s purpose has been threefold: to gain an understanding of consumer needs in other than automobile lines; to examine the activities of the insurance industry in meeting those needs; and to consider both consumer needs and industry performance, in the context of the entire general insurance system, with a view to arriving at conclusions regarding the government’s involvement in initiating improvements and supervising the industry. The Committee’s approach toward its current investigations, to learn more about the general insurance system and the property and casualty sector in particular, is outlined next.

B. APPROACH TOWARDS THE STUDY INTO PROPERTY AND CASUALTY INSURANCE

1. Scope of Current Study

In its Second Report, the Committee announced its intention to continue its studies and to submit subsequent Reports on other aspects of the business of general insurance and of life insurance. It was agreed that the topic of life insurance should be dealt with in a separate report and that attention should be directed next toward consideration of property and casualty insurance as the remaining sector of the general insurance industry, other than the automobile insurance sector.

In its preliminary investigations into the general insurance field, it became evident to the Committee that it could not consider accident and sickness coverage in any detail without encroaching into the activities of life insurance companies, the principal writers of this coverage. *Accordingly the Committee decided to defer consideration of accident and sickness coverage to its later investigations into life insurance.*

2. The Committee’s Investigations

The Committee approached its most recent investigations through a series of public sessions. The first three days of the Committee’s sessions

in July 1978 were devoted to an overview presentation of the property and casualty insurance industry prepared by the Committee's consultants.

This introduction was followed by the acceptance of the invitation by Royal Insurance Company of Canada to visit its office premises and meet with representatives of its various departments in order to gain an on-site appreciation into the operations of the general insurer. In the course of the sessions that followed, the Committee also visited an independent agency in Woodstock, Ontario, the offices of the Underwriters' Laboratories of Canada, The Ontario Mutual Insurance Association, the Insurance Crime Prevention Bureaux and the offices of the Superintendent of Insurance. These visits assisted Committee members in learning in some detail how the general insurance industry is operated and supervised.

Following the initial briefing of the overview presentation and the visit to the Royal Insurance offices, the Committee received submissions from various interested groups and individuals and requested presentations or appearances from other persons and organizations. It was the intention of the Committee in these sessions to assemble, from various perspectives, sufficient information on the many components of the industry to allow the Committee to obtain a thorough understanding of the operations of the industry and to identify possible problems or concerns of both insureds and participants in the industry.

Beginning with the overview presentation, the Committee was able to learn about the organization, financial and operating structure of the general insurance industry. This background assisted the Committee in understanding the operations of the industry and led to certain conclusions regarding the insurance system. Information on the structure and operations of the property and casualty insurance industry is provided in Chapter 3 to follow.

The Committee commenced its deliberations by addressing itself to a separate consideration of two basic component parts of general insurance: personal lines coverages and commercial lines coverages. It appeared evident that a distinction should be made between the individual and the commercial firm as a buyer of insurance. The need for coverage, the types of risks to be insured and the assistance required in purchasing coverage appeared to differ in the case of an individual and in the case of a commercial business. These differences were explored by the Committee during its public sessions.

The Committee also recognized that both personal and commercial lines of insurance required thorough attention. While the performance of the insurance industry in personal lines has direct impact on the individual consumer, the Committee also considered that availability of insurance at reasonable cost to the commercial customer has an indirect impact on the general public. High commercial insurance costs or costly alternatives to

insurance are likely to be passed on to the customer in the price of goods or services bought. Attention to industry performance in commercial lines is furthermore essential because of the adverse effect on jobs and the economy that can result if the business community is unable to protect itself against losses that hamper business activity or close down operations.

In pursuing its intention to examine both personal lines and commercial lines of insurance, the Committee contacted by mail and by telephone numerous persons, consumer groups, trade associations and insurance industry representatives to invite them to present their concerns and comments before the Committee. The Committee received considerable cooperation and assistance from various persons and companies at all levels of the general insurance industry and was able to gain valuable insight into the sellers' perspective of the insurance system.

The Committee was also pleased to hear from several consumer representatives and from a number of commercial insurance user groups. However, the Committee found that property and casualty insurance matters did not appear to be a priority among many of the groups contacted; certainly of less priority than automobile insurance.

In general, the Committee found a lack of consumer response to its requests for submissions on the matter of personal lines of insurance. In addition to its mailed requests for submissions, the Committee discussed the possibility of widespread advertising to generate individual consumer response. This programme was not undertaken for reasons which pointed toward the strong likelihood of a very low response rate. Primary among these reasons was the fact that relatively few claims and few disputes occur in property and casualty lines of insurance compared to the many claims in the automobile insurance system.

As a result of its investigations into both personal and commercial lines of general insurance, the Committee realized that an exhaustive study into each individual component or product line in the general insurance industry would be impossible without considerable time and resources. It also became increasingly evident that many concerns in personal and commercial lines were basically similar in nature and could be addressed under a number of broad issues that affect the general insurance system as a whole. Therefore, in structuring its Third Report, the Committee decided first to deal with specific problems and concerns in the property and casualty sector along with broader considerations related to the ability of the private insurance system to assist consumers in all aspects of coping with losses. The issues considered within the Third Report were described in Chapter One and include capacity; availability, cost and coverage; communications; qualifications and conduct; loss prevention; and other matters.

Second, the Committee undertook to pursue some of the issues re-

garding government presence in the insurance industry which, as previously described, were outstanding from its Second Report. For example, the Committee supplemented its prior review of the responsibilities and operations of the Office of the Superintendent of Insurance with a visit to the Superintendent's office premises.

In this regard, the Committee instructed its consultants together with representatives of the Superintendent's Office to conduct a detailed investigation of ways of implementing an open competition system of rate regulation and to give further consideration to the appropriateness of solvency and liquidity rules, which topics were deferred from the Second Report. To complement this study, the Committee also had the benefit of conferring with representatives of the National Association of Insurance Commissioners (N.A.I.C.) in the United States through the visit of a sub-committee to N.A.I.C. offices in Milwaukee, Wisconsin. Among other matters, the discussions in Milwaukee provided visiting Committee members with insight into developments in the United States regarding the concept of "open competition" regulation of the insurance industry.

Together with the Committee's conclusions regarding the issues of capacity, availability, cost and coverage, communications, qualifications and conduct, and loss prevention, the information derived from consideration of a system of open competition regulation assisted the Committee in undertaking to rationalize the government presence in the insurance industry. The Committee's observations on the monitoring of open competition and on solvency regulation are presented in Chapter 8 of Part III.

CHAPTER 3

The Property and Casualty Insurance Industry in Ontario

A. INTRODUCTION

This chapter deals with the property and casualty insurance industry in Ontario today—its size, how it is organized and financed, the types of insurance it sells, its profitability and its operating cost structure. In the first two Reports on Automobile Insurance, the Committee had the opportunity to undertake a similar examination of the automobile insurance sector of the total general insurance industry. The Committee found that its study into automobile insurance provided a good base from which to highlight differences in the remaining general insurance lines and therefore comparisons to the automobile insurance industry in this Province are made in the overview which follows.

As previously indicated, the Committee deferred consideration of accident and sickness insurance to its later studies into life insurance in consideration of the fact that the life insurance companies are the principal writers of this coverage. Corresponding to this decision, consideration of Fraternal Societies, Prepaid Medical Associations and Mutual Benefit Societies, who also write accident and sickness insurance, and other forms of benefits insurance, is also deferred to the subsequent deliberations on the life insurance industry.

Accordingly, the focus of the Committee's current study in the field of general insurance is on the property and casualty sector of the insurance industry, excluding automobile. Accident and sickness insurance is not considered to be part of general insurance and is also excluded from the current study. *Throughout this Report, the property and casualty insurance sector is defined to represent all lines of general insurance with the exception of automobile insurance.*

B. SIZE OF THE PROPERTY AND CASUALTY INSURANCE MARKET

As of December 31, 1977, the property and casualty insurance industry in Ontario wrote \$904 million in direct premiums. This amount compares to \$1,092 million in automobile premiums in the same year and \$485 million in accident and sickness premiums. Approximately one-third of the property and casualty insurance in Canada is written in Ontario.

Over the 1973-1977 period, both the property and casualty insurance market and the automobile insurance market have grown significantly in terms of premium dollars. Non-automobile lines increased by 116% from \$417 million direct premiums written in 1973 to \$904 million in 1977,

**THE NON-LIFE INSURANCE MARKET IN ONTARIO AND CANADA
MARKET SIZE BY DIRECT PREMIUMS WRITTEN, 1977**

Class	In Ontario			In Canada	
	\$000's	% of Total General	% of Total Canada	\$000's	% of Total General
Property and Casualty	903,763	36.4	33.6	2,688,842**	38.8
Automobile	1,092,648	44.0	35.4	3,082,490**	44.5
Accident and Sickness*	484,916	19.6	41.8	1,159,353	16.7
Total of Above	2,481,327	100.0	35.8	6,930,685	100.0

* Includes premiums written by life insurance companies and general insurance companies; excludes premiums written by fraternal societies, prepaid medical associations and mutual benefit societies (amounting to \$84,620,000 in Ontario).

** Includes insurance written by provincial government corporations.

whereas automobile lines grew by 99% from \$548 million to \$1,092 million over the same period.

C. STRUCTURE OF THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

1. Number of Organizations

In total, 260 companies or other organizations marketed property and casualty insurance products in Ontario at December 31, 1977. Of these organizations 52 were farm mutual insurance corporations, who are permitted under the Corporations Act to underwrite only those risks associated with agricultural property.

The Committee's First Report¹ indicated that 181 individual organizations were licenced in 1975 to write automobile insurance in Ontario, compared to a total of 260 property and casualty insurers identified in this Report in 1977. Of the 181 organizations writing automobile lines, 173 also wrote other general insurance. Therefore, some 65 percent of property and casualty insurers also wrote automobile insurance.

2. Ownership and Jurisdiction of Incorporation

Property and casualty underwriting organizations are summarized by their ownership and jurisdiction of incorporation as follows:

An analysis of the ownership of these organizations shows that foreign-owned general insurance companies outnumber Canadian-owned companies and that the foreign-owned companies capture almost three-quarters of the Ontario property and casualty insurance market. This ownership and

1. *First Report on Automobile Insurance*, pages 185 to 189.

**THE PROPERTY AND CASUALTY INSURANCE INDUSTRY IN ONTARIO
PROFILE OF COMPANIES BY OWNERSHIP AND JURISDICTION, 1977**

Ownership and Jurisdiction	Number of Organizations		Direct Premiums Written	
	Number	Percent	\$000's	Percent
<i>Canadian-owned Companies</i>				
Federal incorporated	36	13.9%	\$185,237	20.5%
Ontario incorporated	11	4.2	43,741	4.8
Farm Mutuals	52	20.0	26,915	3.0
Total	99	38.1	255,893	28.3
<i>Foreign-owned Companies</i>				
Federal incorporated	42	16.2	302,027	33.4
Ontario incorporated	8	3.0	44,312	4.9
British branch	22	8.5	47,052	5.2
Other foreign branch	89	34.2	254,479	28.2
Total	161	61.9	647,870	71.7
Total all Insurers	260	100.0%	\$903,763	100.0%
Insurers Resident in Canada	149	57.3%	\$602,232	66.6%

market share pattern is similar to the one found in the automobile insurance industry.

However, many of the foreign-owned insurers are incorporated in Canada and can be termed resident in Canada. Consequently, insurers resident in Canada wrote 66.6 percent of total direct premiums in Ontario in 1977, composed of the share written by Canadian-owned companies (25.3%), farm mutuals (3.0%) and the foreign-owned Canadian-incorporated companies (38.3%). The remaining 33.4 percent of total direct premiums was written by the branch offices of foreign-owned organizations. This market distribution also compares with similar experience in automobile insurance.

Further analyses of the industry structure show that 189 of the organizations, accounting for 87 percent of premiums written, are either Canadian-incorporated companies or branches of British or other foreign organizations and report to the Federal Superintendent of Insurance. 71 of the companies, accounting for 13 percent of premiums written, are either incorporated in Ontario or are farm mutuals and therefore report directly to the Ontario Superintendent of Insurance.

3. Affiliation by Group and Distribution by Premium Volume

Many of the 260 individual organizations licenced to write property and casualty insurance are affiliated with others. Excluding farm mutuals, of the other 208 individual organizations, 86 were identified to be affiliated with others to form 38 groups. Combining companies by their known group affiliations reduces the number of Canadian-owned organizations, excluding farm mutuals, to 40 and foreign-owned to 120, for a total of 160 (compared with about 130 in the automobile insurance field). An analysis of these 160 groups, ranked by direct premiums written in 1977, shows:

**THE PROPERTY AND CASUALTY INSURANCE INDUSTRY IN ONTARIO
STRUCTURE BY SIZE AND OWNERSHIP OF GROUPS, 1977**

Direct Premiums Written, 1977, (\$000's)	Ownership		
	Canadian	Foreign	Total
Less than \$5	0	11	11
\$ 5-\$ 1,000	12	49	61
\$1,000-\$ 5,000	13	26	39
\$5,000-\$20,000	13	26	39
Over \$20,000	2	8	10
Total Property and Casualty	40	120	160
Total Automobile	33	97	130

Almost half of the total groups writing property and casualty insurance wrote premiums of less than \$1 million in 1977 and ten wrote more than \$20 million. In automobile insurance as many as 13 groups were found to be writing more than \$20 million in premiums in 1975. Of the Canadian-owned groups writing property and casualty, 15 wrote in excess of \$5 million in 1977 compared to only 8 Canadian-owned groups writing this amount of automobile insurance business in 1975. Two Canadian-owned groups wrote in excess of \$20 million in property and casualty insurance in 1977 while three such groups wrote more than \$20 million in automobile insurance two years earlier.

4. Concentration

The large number of companies or groups writing property and casualty lines and the wide distribution of companies by premium volume indicates that the general insurance industry in Ontario is on average less concentrated than the automobile insurance industry. The following analysis of the degree of concentration in the industry, based on group affiliation and excluding farm mutuals, substantiates this observation:

**THE PROPERTY AND CASUALTY INSURANCE INDUSTRY IN ONTARIO
CONCENTRATION PROFILE, 1977**

Number of Organizations/Groups	Direct Premiums Written—1977		Percent Canadian-owned	
	(\$000's)	Percent	Of Size Group	Of Total
5 Largest	\$220,235	25.1%	12.3%	3.1%
10 Largest	334,740	38.0	14.7	5.6
25 Largest	559,998	63.8	22.9	14.6
Total	\$876,848	100.0%	26.1%	26.1%

In comparison to the relatively fragmented distribution of property and casualty business indicated in total above, analysis in the First Report showed a higher company concentration in 1975 in the automobile insurance industry. In that year in the automobile field, the five largest groups wrote almost one-third, the ten largest wrote approximately one-half and the 25 largest groups wrote about three-quarters of the total market.

In the automobile insurance industry, one Canadian-owned organization was included in the five largest and two and six respectively in the ten and twenty-five largest. In the property and casualty insurance industry the representation of Canadian-owned companies is seven among the top twenty-five organizations, or one more than in automobile, with two represented in the top ten companies and one in the top five. The twenty-five largest groups writing property and casualty insurance are listed below according to direct premiums written and market share in 1977. A full listing of the property and casualty insurance companies operating in Ontario at December 31, 1977 is provided in Appendix C.

It is important to note that the automobile insurance industry is a relatively homogeneous industry in comparison to the property and casualty sector which markets a wide range of insurance product lines. This lack of homogeneity might of itself indicate less concentration in the total property and casualty sector caused by a greater number of specialty companies. Specific market segments of the total might, however, exhibit a relatively greater degree of concentration; this matter is examined again later in this Chapter.

**THE PROPERTY AND CASUALTY INSURANCE MARKET IN ONTARIO
THE TWENTY-FIVE LARGEST GROUPS AND ORGANIZATIONS, 1977**

	<u>Country of Incorporation of Parent Organization</u>	<u>Direct Premiums Written, 1977</u>	
		<u>(\$000's)</u>	<u>Percent of Total</u>
Royal Insurance Group	British	94,240	10.7
Commercial Union Assurance Group	British	36,899	4.2
Factory Mutual System	U.S.	33,531	3.8
General Accident of Canada	British	28,530	3.3
Economical Mutual Insurance Company	Canadian	27,035	3.1
Zurich Insurance Company	Swiss	24,554	2.8
Lloyd's	British	24,081	2.8
Dominion of Canada Group	Canadian	22,239	2.5
Shaw & Begg Group	U.S.	22,066	2.4
Continental Insurance Companies	U.S.	21,565	2.4
10 Largest		\$334,740	38.0%
Cooperators Insurance Association	Canadian	19,561	2.2
Guardian Insurance Company of Canada	British	19,538	2.2
Crum and Forster of Canada	U.S.	17,616	2.0
Canadian General Group	Canadian	16,631	1.9
Simcoe Bay Group	Canadian	16,428	1.9
Chubb and Son Group	U.S.	15,010	1.7
Allstate Insurance Company of Canada	U.S.	14,705	1.7
U.S. Fidelity Group	U.S.	14,347	1.7
Canadian Indemnity Company	Canadian	14,215	1.6
Insurance Company of North America	U.S.	13,761	1.6
American Home Assurance Company	U.S.	13,402	1.5
Anglo-Gibraltar Group	British	12,927	1.5
Phoenix of Canada Group	British	12,925	1.5
State Farm Insurance Companies	U.S.	12,244	1.4
Gore Mutual Insurance Company	Canadian	11,948	1.4
25 Largest		\$559,998	63.8%

D. PRODUCT LINES IN THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

1. Major Classes of Property and Casualty Insurance

Property and casualty insurance is as pervasive as risk. As a result, there are well over 100 defined types of property and casualty insurance products designed to cover the major risks faced by individuals and businesses. These products can be grouped in numerous ways corresponding to type of customer, for example personal or commercial; type of peril, for example fire or theft; type of risk, such as residential property or office complex; and so on.

The Committee has adopted in its study those broad groupings which are reasonably consistent with the categories of product utilized by the Insurance Bureau of Canada in its statistical gathering programmes and with the categories utilized by the Federal and Provincial Superintendents in their annual reports. The three basic categories of property and casualty insurance studied by the Committee and reported upon in this Report are:

- property insurance;
- liability insurance, including surety and fidelity;
- “other lines” of insurance composed exclusively of marine, aircraft, boiler and machinery, mortgage, credit and title insurances.

The table below shows the relative size of the market for the basic lines of property and casualty insurance:

THE PROPERTY AND CASUALTY INSURANCE MARKET IN ONTARIO
DIRECT PREMIUMS WRITTEN BY PRODUCT CLASS, 1977
(\$000's)

Property	Companies	Farm Mutuals	Total	Percent
Property	\$644,385	\$25,318	\$669,703	74.1%
Hail	2,887	53	2,940	.3
Property Total	647,272	25,371	672,643	74.4
Liability				
Liability	140,614	1,544	142,148	15.7
Surety	17,979	—	17,979	2.0
Fidelity	10,396	—	10,396	1.1
Liability Total	168,989	1,544	170,533	18.8
Other Lines				
Marine	18,0001	—	18,001	2.0
Boiler and Machinery	21,885	—	21,885	2.4
Mortgage	12,226	—	12,226	1.4
Aircraft	7,874	—	7,874	.9
Credit	543	—	543	.1
Title	58	—	58	—
Other Lines Total	60,587	—	60,587	6.8
Total	\$876,848	\$26,915	\$903,763	100.0%

Property insurance is the second largest line of the general insurance written in Ontario, behind automobile insurance, and it accounts for three-quarters of premiums written in the non-auto segment of general insurance. Liability insurance, which represents only sixteen percent of non-auto general insurance, is the next largest component of the property and casualty insurance market. The remaining lines, including surety and fidelity, represent in total only 10% of the market, with only the boiler and machinery line representing more than \$20 million in premiums. Following below are definitions of the basic property and casualty insurance categories and the major classes of insurance included under these categories.

Property Insurance

The property insurance category includes insurance coverages for both personal and commercial interests in property. Property can be broadly defined to include not only physical or tangible assets, but also other interests which possess economic value such as rents or profits.

In personal lines, property insurance includes all homeowner's and tenant's policies and provides, in the case of package policies, protection against personal liability as well as physical loss. In commercial lines, property insurance includes all fire, theft and other perils policies covering plant, equipment and contents losses. In addition, coverages to protect against loss of business income fall within this category.

Liability Coverage

The liability insurance category is primarily a commercial lines category since most personal liability policies are sold as part of a homeowner's or tenant's property insurance package. Excluded also are forms of liability insurance that fall within the "other lines" category. Included in the category—liability coverage—are all remaining policies that protect against the financial losses that result from legal liability, including general liability, products liability, and professional liability coverages.

Guarantee forms of insurance, that is, surety and fidelity bonds, are also grouped in the liability category. In some ways similar to liability coverages, surety bonds involve a three party process—protection is offered to a third party and not to the bond applicant. However, surety bonds differ from the typical insurance contract since ideally there should be no losses under the bond contract. Steps are taken to investigate applicants to ensure that the likelihood of losses is kept to a minimum. The most typical surety form is the contract fulfilment guarantee in the construction industry.

Fidelity bonding is a specialized form of surety bonding that protects an employer against dishonest acts by employees. It has evolved into a two-party contract between the insurer and the employer and more closely resembles insurance than the other types of surety bonds.

“Other Lines” Insurance

Included under this category are coverages for risks within six defined specialty markets. This category is therefore not a “catch-all” category, but is restricted to the six lines described below.

— Marine

Marine insurance is primarily concerned with hull, cargo and liability coverage for risks associated with maritime perils. However, marine insurance may also cover losses resulting from transit by air, losses consequent upon or incidental to sea and air navigation, and also perils during land and inland water transport. Marine insurance is regulated under a separate act in this Province, the Marine Insurance Act.

— Aircraft

Aircraft insurance is also a broad classification that embraces all risks encountered in, or associated with, the ownership, maintenance or use of aircraft. Principal insurable interests are hull and liability. Air cargo insurance is often written as a property or marine insurance contract and is typically *not* included in this category.

— Boiler and Machinery

This class of insurance is principally a property insurance providing coverage for loss arising out of the operation of pressure mechanical and electrical equipment. Losses typically covered include damage directly to the equipment insured, damage done to other property and loss resulting from business interruption. Liability coverage may be part of the policy, but is typically written under a general liability policy and is therefore excluded from this category. The boiler and machinery contract permits the insurer to inspect equipment and this service is an important feature of boiler and machinery insurance.

— Mortgage

Mortgage insurance covers the possibility of a default by a mortgagee in payments made to a mortgage lender. It is purchased by the lending institution, but paid for by the borrower and has typically been applied in cases of mortgages exceeding 75% of the value of the property.

— Credit

Credit insurance protects the insured business against abnormal losses on accounts receivable, due to the unwillingness or inability of debtors to pay. Export credit insurance, which protects against credit risks and political risks, is written by a federal government corporation and is not included in this category.

— Title

Title insurance reimburses the insured for any losses that may be incurred if a title to real estate proves to be defective. One premium is paid for the insurance which continues until the insured's interest in the property ceases.

More detailed definitions of the property and casualty insurance products are provided in Appendix F.

2. Concentration by Class of Property and Casualty Insurance

The degree of concentration in the property and casualty insurance industry by broad class of insurance is illustrated in the table below.

THE PROPERTY AND CASUALTY INSURANCE MARKET IN ONTARIO
MARKET SHARE OF FIVE LARGEST GROUPS BY PRODUCT CLASS,
DIRECT PREMIUMS WRITTEN, 1977

	Five largest Writers—Percent of Total Ontario Market in Each Class %	Share Held by Largest Writer %	Percent of Total Direct Premiums Written—1977 %
Property			
Property	24.2	9.9	74.1
Hail	91.7	31.6	.3
Liability			
Liability	34.5	13.5	15.7
Surety	48.4	15.0	2.0
Fidelity	48.8	15.9	1.1
Other Lines			
Marine	52.2	20.7	2.0
Boiler and Machinery	86.7	40.9	2.4
Mortgage (3 companies)	100.0	66.8	1.4
Aircraft	63.9	15.7	.9
Credit (3 companies)	100.0	95.6	.1
Title (2 companies)	100.0	98.9	—
Total Property and Casualty	25.1	10.7	100.0%

The five largest groups accounted for a 25.1 percent share of the Ontario market in all classes of property and casualty insurance combined. The 10.7 percent share held by the largest underwriting group is the result of a market share position among the top five writers in the property, liability, fidelity and boiler and machinery classes of insurance.

As indicated in the table above, the least concentrated classes of insurance are the property and liability classes which are also the largest in terms of premium volume. Concentration increases with product specialization and with a decrease in market size. Surety, fidelity, marine and aircraft classes are only moderately concentrated considering the small premium volume generated in Ontario by these classes of insurance. Mortgage, credit and title classes of insurance are dominated by two or three companies; however, only in the case of mortgage insurance is there any significant premium volume to be shared among competitors. Hail insurance and boiler and machinery insurance also show a high degree of concentration.

It is most important to note that the market share data presented in this section are based on a *broad* grouping of product lines into categories that

correspond to government and industry reporting requirements. However, more *detailed* market or product line segments can be defined within these categories which *might show a different pattern of concentration* from the group average. It is likely that concentration would increase with a narrower definition of product lines. Reliable data on the premiums written in more detailed product line groupings are not available.

3. Growth by Class of Property and Casualty Insurance

The pattern of growth in premiums varies considerably among the various classes of insurance over the 1973-1977 period. Details of the growth in direct premiums written for this period are shown in Appendix G, together with a comparison to all Canada market growth. Growth in the Ontario market is summarized below for the major classes of insurance.

THE GENERAL INSURANCE MARKET IN ONTARIO
GROWTH IN DIRECT PREMIUMS WRITTEN, 1973-1977
(1973 = 100.0, growth in current dollars)

	1973	1974	1975	1976	1977	Average Annual Growth 1973-1977
Property	100.0	116.7	137.9	184.4	222.3	22.2%
Liability	100.0	108.5	135.0	170.8	215.5	21.4%
Other Lines	100.0	113.2	142.1	136.1	171.8	14.5%
Total Property and Casualty	100.0	114.8	137.7	177.6	216.6	21.4%
Automobile	100.0	115.7	148.5	175.4	199.1	18.9%
Consumer Price Index	100.0	110.8	122.8	132.0	142.6	9.3%

Premiums written in the property and liability classes of insurance increased at closely similar rates of growth over the 1973-1977 period, averaging 21-22% per annum. The "other lines" class of insurance experienced considerable year to year variability in premium growth, averaging 14.5% per annum. These growth rates compare with an average 18.9% per annum growth in automobile lines. The greatest premium volume increases occurred in 1975 for automobile and liability lines and a year later in 1976 for property lines.

Further analyses¹ indicate that growth rates in certain product sub-classes vary significantly from the average for the class. The sub-classes of surety and fidelity, for example, showed slower growth than the liability class as a whole, averaging 11-14% per annum over the indicated period, while hail insurance showed almost no growth in premium volume by 1977. In the "other lines" class of insurance, mortgage insurance showed substantial growth in 1977 while title insurance decreased dramatically in 1975 and

1. Supra, Appendix G, Table 3.

1976, but resumed growth in 1977. Marine, boiler and machinery and aircraft classes grew in premium volume at average annual rates of 11.2%, 26.9% and 12.4% respectively.

E. FINANCIAL OVERVIEW OF PROPERTY AND CASUALTY INSURERS

1. Introduction

This section provides some brief general observations about the operating results of property and casualty insurers for the three major product lines of property, liability and “other lines” insurance and for the personal and commercial components of property insurance.

The estimated income statements of property and casualty insurers operating in Ontario are summarized below by lines of business for the years ended December 31, 1973 to 1977.

Appendix D to this Report contains the estimated annual income statements for the years ended December 31, 1973 to 1977, for each of the lines of business conducted by property and casualty companies reporting to the Ontario Department of Insurance. Also included in this Appendix are the assumptions made and procedures used to develop the estimates analyzed throughout this section as well as the bases of refining and updating the estimates for the automobile insurance industry. A brief description of the farm mutual and Lloyd’s organizations and their operating results is presented in Appendix E.

2. Industry Financial Results and Profitability

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING RESULTS, FIVE YEAR AVERAGE, 1973-1977

	Automobile	Property	Liability	Other Lines
Premiums Earned	100.0%	100.0%	100.0%	100.0%
Claims Incurred*	75.1	59.8	61.6	62.1
Commission Expense	12.7	20.7	20.4	15.9
Premium Tax	2.5	2.8	2.7	3.3
General Expense	13.1	18.7	18.4	21.3
Investment Income	(10.2)	(8.3)	(13.9)	(19.6)
	93.2	93.7	89.2	83.0
Profit before				
Income Taxes	6.8%	6.3%	10.8%	17.0%
Premiums Earned				
(millions)	\$772.1	\$384.8	\$98.7	\$33.5

* Including adjusting costs charged directly to the claim file.

The above table indicates, for the periods shown, that:

1. Of every \$1.00 of premiums earned by the industry, 59.8¢ to 75.1¢ was used to settle and adjust claims. Information concerning adjusting

costs which have been charged directly to the claims file is recorded as part of claims incurred and is not reported separately. It is therefore not available to the Committee.¹ In the First Report, claims expenses were roughly estimated, based on periodic analyses conducted by the industry, at about 11¢ of every \$1.00 of automobile premium earned by the industry.

The highest claims incurred ratio was in the largest product line, automobile insurance. In some part this might be a reflection of lower premium levels or greater expense control caused by keener competition amongst a greater number of writers. Further comment on expenses is provided below. In general, however, the claims incurred ratio for non-automobile lines fell significantly below the automobile ratio.

2. Expenses that are identified as "commissions" account for a low of 12.7¢ of each premium dollar in automobile insurance to an average of 20.7¢ in property insurance. Other marketing expenses, such as advertising and sales staff salaries, are not reported separately, although they contribute to the portion of the premium dollar paid by the consumer for the industry's "selling" expenses.
3. A premium tax is levied on the basis of total direct premiums written by insurers. The rate of premium tax was increased to 3% on April 1, 1976 from the previous 2%. The total amount of this tax collected in 1977 amounted to approximately \$58 million, \$26 million in non-automobile lines.
4. General expenses, the "catch-all" for expenses not specifically identified elsewhere, absorbed 13.1¢ of each premium dollar in automobile insurance and between 18.4¢ to 21.3¢ in property and casualty lines. In addition to the costs of administering the overall operations of insurance companies, "general expenses" would include marketing expenses, except commissions, and claims handling expenses, other than those specifically identified as adjusting expenses and grouped with claims incurred.
5. The foregoing costs were offset by investment income which varied considerably from 8.3¢ for each \$1.00 of premiums in property lines to 19.6¢ in the "other lines" category. Investment and other income reduced net costs and expenses to about 89¢ and 83¢ in liability and other lines respectively, leaving a profit before income taxes of about 11¢ and 17¢ for each dollar of premiums earned. In contrast, the reduction in net costs and expenses by the addition of investment income was much lower in property and automobile lines so that the profit before income taxes amounted to only 6.8¢ for each \$1.00 of premiums earned in automobile lines, and 6.3¢ in property lines.

1. Supra, pages 41, 42 and 53.

Reflecting the allocation method used, investment income is highest on lines with the longest claims payout time frame. For example, liability claims may take several years to settle whereas property claims are generally settled in a much shorter period of time. The longer payout period allows longer investment of funds and correspondingly greater investment income to be earned. High unearned premium reserves in lines, such as mortgage insurance, where policies are written for terms exceeding one year also contribute to increased investment income.

6. As an approximation based on the overall experience of the industry, the rate of income taxes would take one-third of the profit before tax, leaving about 7.2¢ of each premium dollar in liability and 11.3¢ of each premium dollar in liability and 11.3¢ of each premium dollar in other lines for the owners as a return on their investment and to finance future growth. In property lines, 4.2¢ was left as a return on the owners' investment while 4.5¢ of each premium dollar remained in the automobile lines.

The average profitability over the five year period for the major classes of property and casualty insurance (automobile and property) was lower than for the liability and other lines portion of the insurance industry.

While average profitability was lower in the property and automobile class over the five year period shown, both these lines showed a significant improvement in profitability for 1976 and 1977. In general, annual profits earned by individual companies and by the industry as a whole have been subject to wide fluctuations over the 1973 to 1977 period not only within individual classes of insurance but also in total for all general insurance lines combined. This volatility of profits is demonstrated in the estimated income statements shown in Appendix D.

3. Return on Equity

a) Pre-Tax Product Line Comparison

The following table has been developed to present a five year, 1973-1977 average of the estimated pre-tax return on equity by each major class of insurance for general insurers operating in Ontario, together with an all Ontario comparison to all Canada (excluding farm mutuals and Lloyd's):

These estimates show that the average profitability over a five year period for automobile and property insurance was lower than for the liability and other lines portion of the insurance industry. However, it would appear that there was a significant improvement in the profitability of both automobile and property insurance in 1976 and 1977 in relation to the average over the five year period.

THE GENERAL INSURANCE INDUSTRY IN ONTARIO AND CANADA

ESTIMATED PRE-TAX RETURN ON EQUITY, 1973-1977

(\$ millions)

General Insurance Lines	Average 1973-1977			1976	1977
	Capital and Surplus (Equity)	Profit (Loss) Before Income Taxes	Pre-Tax Return on Equity	Pre-Tax Return on Equity	Pre-Tax Return on Equity
Automobile	\$ 339.0	\$ 52.0	15.3%	28.7%	25.3%
Property	168.4	24.0	14.3%	17.6%	28.6%
Liability	43.4	10.4	24.0%	31.2%	(7.0)%
Other	14.8	5.4	36.5%	53.3%	52.9%
Total Ontario	\$ 565.6	\$ 91.8	16.2%	31.7%	24.4%
All Canada	\$1,381.0	\$201.2	14.6%	22.2%	26.4%

The Ontario pre-tax return on equity for the five year period 1973-1977 was estimated to be 16.2% for all general insurance lines, which was marginally higher than the 14.6% estimated for all Canada. The return on equity is lowest for the two largest classes of insurance. As previously noted, these classes generally have a shorter time frame for claims payout and as a result are least able to rely on claims reserves for financing. Accordingly, they require the highest capital investment.

The improved profitability in 1976 and 1977 in most classes of property and casualty insurance in Ontario made possible a relatively significant increase in average equity. However, growth in equity for the Ontario segment of the insurance industry remained moderate over the 1973-1977 period, averaging 12.5% annually.

b) After-Tax Industry Comparison

The table below presents a comparison of the estimated after-tax return on the shareholders' investment (equity) in the property and casualty insurance industry with that achieved in other industries in Canada for the years 1973 to 1977.

THE PROPERTY AND CASUALTY INSURANCE INDUSTRY IN ONTARIO AND CANADA

COMPARISON WITH OTHER INDUSTRIES OF

ESTIMATED RATE OF RETURN (AFTER-TAX) ON EQUITY, 1973-1977

Industry		1973	1974	1975	1976	1977	Five Year Average
Total All Industries	(1)	13.9%	15.3%	13.0%	11.8%	12.1%	13.1%
All Manufacturers	(1)	14.6	16.9	13.6	12.2	12.6	13.8
Chartered Banks	(1)	12.6	12.4	15.9	14.4	14.1	14.0
Trust Companies	(1)	11.8	8.2	10.6	11.8	11.8	11.0
Property and Casualty Insurers—Canada	(2)	5.6	(2.7)	9.2	15.3	18.1	10.1
Property and Casualty Insurers—Ontario	(3)	11.6	.8	9.7	17.8	19.7	12.7

Sources of Information:

(1) Statistics Canada

(2) Statistics Canada (includes Accident and Sickness)

(3) Estimated in preceding section (excludes Accident and Sickness)

Examination of the table points out the following:

1. In each year the property and casualty insurance industry earned a higher estimated return on the Ontario segment of its business than it earned on an all Canada basis.
2. The five year estimated average return for the property and casualty industry in Ontario is comparable to the return earned by other industries. However, the Ontario insurers' estimated annual return on equity fluctuated widely while the annual return of the other industries remained relatively constant.

4. Personal and Commercial Property Lines

The operating results of the *property component* of the property and casualty insurance industry can be further examined by comparison of personal property and commercial property lines of insurance.¹

The Provincial and Federal Superintendents of Insurance require companies to report property insurance in total only. They do not require separate reporting for the personal and commercial components of property insurance. As a result, only data gathered by the Insurance Bureau of Canada were available to estimate the profitability of the personal and commercial components of the property class. The estimates presented therefore must be considered rough since the I.B.C. data are collected on the basis of direct premiums written and several assumptions had to be made to convert them to an "earned" basis. Further, no alternate source of information was available with which to compare the results for reasonability.

The summary estimated income statement in Appendix D shows a split of Ontario property insurance business between commercial and personal lines for the four years ended December 31, 1974 to 1977. Combining the data on this statement for the four years shows:

THE PROPERTY AND CASUALTY INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING RESULTS IN
PROPERTY INSURANCE, FOUR-YEAR AVERAGE, 1974-1977
(\$ millions)

	Personal		Commercial	
Premiums earned	\$180.5	100.0%	\$234.2	100.0%
Claims incurred*	110.7	61.3	137.1	58.5
Commission expense	39.2	21.7	46.2	19.7
General expenses	34.9	19.3	42.2	18.0
Premium taxes	5.4	3.0	6.4	2.7
Investment income	(14.8)	(8.2)	(19.2)	(8.2)
	<u>175.4</u>	<u>97.1</u>	<u>212.7</u>	<u>90.7</u>
Profit before income taxes	\$ 5.1	2.9%	\$ 21.5	9.3%

* Including adjusting costs charged directly to the claims file.

1. As it is understood that all homeowner's insurance, including liability coverage, is included within the property class when reporting to various industry and regulatory bodies, the analysis of personal lines has been restricted to the property class of insurance.

Analysis of this table and supporting data indicates, for this period, that:

1. On average commercial lines represent approximately 60% of the total property insurance business while personal lines represent 40%. In recent years, however, personal lines appear to be growing more rapidly than commercial lines.
2. Of every \$1.00 premium earned, personal lines used 61.3¢ and commercial lines used 58.5¢ to settle and adjust claims.
3. Commissions paid on personal lines were 2.0¢ higher than on commercial lines per premium dollar, averaging 21.7¢ in the case of personal lines and 19.7¢ for commercial lines.
4. General expenses for personal lines were 1.3¢ higher than for commercial lines.
5. The profit before income taxes for each dollar of premium earned was 9.3¢ for commercial lines, 2.9¢ for personal lines.

Additional personal lines data for Northern and Southern Ontario on an average basis for the years 1974-1977 were also examined; among other matters they indicate:

1. 92% of Ontario personal lines premiums were earned in Southern Ontario and only 8% in Northern Ontario. As defined by the I.B.C., Northern Ontario includes Northwestern Ontario and is divided from Southern Ontario by the southern boundary of the District of Nipissing and the District of Sudbury.
2. Claims incurred averaged 71.3¢ per earned premium dollar in Northern Ontario, and 60.4¢ per earned premium dollar in Southern Ontario.

Based on the data developed above, personal lines insurance was less profitable than commercial lines insurance during the period 1974-1977.

F. OPERATING COST STRUCTURE OF THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

As part of its automobile insurance study, the Committee analyzed the major functional components of the operating costs of automobile insurers—acquisition, underwriting and policy processing, and adjusting and settlement. Most of these companies also supply other general insurance products to Ontario consumers. In addition to these companies, other companies and groups also supply the property and casualty market. Observations on the detailed operating costs which relate to the other than automobile general insurance products are presented in this section. The procedures used to develop the estimates used in this section as well as more detailed analysis of costs are provided in Appendix D. For the most part, the operating cost data have been prepared from the same sources used in preparing the financial overview in the preceding section, supplemented by operating

statistics produced by the Insurance Bureau of Canada Expense Allocation and Reporting System.

The summary table below presents a comparison, in percentage terms, of the estimated income statements for each of the major classes of insurance marketed by the property and casualty insurers in Ontario. Liability and other lines are combined to permit use of the I.B.C. Expense Allocation and Reporting System for further analysis of operating costs by their functional components.

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING COST PROFILE*

	Costs of Percentage of Premium Dollar Earned			
	Property			Liability
	Auto	Personal	Commercial	and Other
Premiums Earned	100.0%	100.0%	100.0%	100.0%
Claims Incurred**	75.1	61.3	58.5	61.7
Commission Expense	12.7	21.7	19.7	19.3
Premium Tax	2.5	3.0	2.7	2.9
General Expense	13.1	19.3	18.0	19.1
Total Operating Costs	28.3	44.0	40.4	41.3
Total Costs	103.4	105.3	98.9	103.0
Investment Income	(10.2)	(8.2)	(8.2)	(15.4)
Profit (Loss) Before Taxes	6.8%	2.9%	9.3%	12.4%
1977 Estimated Premiums Earned*** (\$million)	\$1,041	\$249	\$285	\$178

* Average annual results for the following periods: property, personal and commercial, 1974-1977; automobile, liability and other, 1973-1977.
 ** Includes the costs of adjusting charged directly to the claims file.
 *** Excluding farm mutuals and Lloyd's.

This summary table provides the base for the comparison in the table below of operating costs by functional component. The following table incorporates a reallocation of general expenses to the three functional cost categories of acquisition, underwriting and policy processing and claims handling.

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING COST PROFILE, BY FUNCTIONAL COMPONENT*

	Operating Costs as Percentage of Premium Dollar Earned			
	Total	Acquisition	Underwriting and Policy Processing	Claims Handling
Personal Property	44.0%	27.8%	12.7%	3.5%
Commercial Property	40.4	25.5	12.8	2.1
Liability and Other Lines	41.3	25.6	12.7	3.0
Automobile	28.3	17.9	7.3	3.1

* For periods of time indicated in the previous table.

Examination of the table above points out the following:

1. Excluding a consideration of adjusting costs which have been charged directly to claims files and recorded as part of claims incurred, the total operating costs of the property and casualty lines range 12-15% higher than those same costs for automobile lines.
2. Acquisition costs are estimated to be 7-9% higher than automobile primarily owing to the higher commission rates associated with the property and casualty lines.
3. Acquisition costs in personal lines are about 2% higher than in commercial property and in liability and other lines. This might be explained by the fact that some portion of the commission rates for commercial property lines and for liability and other lines is negotiable, particularly on larger writings.
4. Underwriting and policy processing costs in the other than automobile lines are roughly 5% higher than in automobile. The commercial lines of insurance, composed of property, liability and other lines, might be expected on average to incur higher costs because they include many specialty policies. However, personal property lines also bear relatively high costs, similar to the levels in commercial lines. As a result, there is a relatively large spread in processing costs between personal property and automobile whereas one might have expected a closer cost relationship because of the similarity between automobile policies and homeowner's policies from an underwriting and processing viewpoint.
5. The administrative costs of adjusting claims appear to bear a reasonably close relationship among the classes of insurance, considering the diverse nature of the claims in these classes.
6. Details are not available segregating adjusting costs charged directly to the claims file in property and casualty lines and, therefore, the estimates of claims handling costs presented above do not include these direct costs. If such details were available, significant differences would be expected among the various classes, reflecting the nature and degree of difficulty of the claims settlement process in each individual insurance class. In the studies into automobile insurance, the Committee was able to estimate, but only roughly, that direct claims adjusting costs accounted for about 11¢ out of each premium dollar earned, bringing total claims handling and adjusting costs to 14.1%.

The preceding organization and financial overview of the property and casualty insurance industry is referred to in later parts of this Report with respect to the Committee's deliberations on issues fundamental to the provision of the insurance product.

CHAPTER 4

Roles and Responsibilities of Insurance Companies in the General Insurance Industry

A. INTRODUCTION

During its studies into general insurance, witnesses before the Committee have reiterated the importance of the relationships between various levels of the industry. In this chapter and the next, the Committee re-examines the roles and functions of the various participants in the general insurance industry, based on its review of the total industry including both automobile and other general insurance lines. This chapter, concerned with the role of insurance companies, and the following chapter, reviewing the roles and responsibilities of sales and claims adjusting intermediaries, form a background to certain of the conclusions that follow in this Report.

The overview in this chapter is organized under the following headings:

- Development of the Insurance Mechanism
- The Underwriting Function
- Marketing of the Insurance Product
- Claims Settlement
- Outline of the Responsibilities of Insurance Companies
- Consumer Complaints Regarding General Insurance

This chapter reviews the findings of the Committee in its first two Reports on automobile insurance and supplements these findings with observations related to a broader view of the general insurance industry that incorporates the property and casualty sector.

B. DEVELOPMENT OF THE INSURANCE MECHANISM

1. General Forms of Organization

The insurer's initial function is to organize the insurance mechanism. The form of organization determines in whose interests the mechanism will be managed. It also determines the manner in which capital is accumulated and profits are distributed. These factors then determine the profitability requirements for future growth in capacity and availability of insurance to meet market demand. The traditional and most common forms of organization in the insurance industry include:

1. *Stock Companies*

Stock companies are organized with capital consisting of shares which may be privately held or may be purchased by the public. The majority of non-life insurance business in Ontario is written by stock companies.

2. *Mutuals*

Mutuals are a pooling arrangement in which a number of individuals put premiums into a common pool to cover future claims. Usually an arrangement is established for further payment, called an assessment, if premiums are insufficient to meet claims. A portion of the premium, called a dividend, may be returned if premiums exceed claims requirements. Mutual companies may be termed cash mutuals when reserves are built to a sufficient level to preclude the assessment requirement. Farm mutual insurance companies¹ are a special class of mutuals. Section 169(13) of The Corporations Act restricts farm mutuals to undertaking contracts of insurance upon agricultural property only.

3. *Reciprocals*

A reciprocal exchange is a type of co-operative insurance. Policyholders are generally few in number and premiums are closely related to claims experience. A reciprocal exchange is very close to self-insurance administered by an “attorney in fact”. Reciprocals are similar to mutual insurers but in a legal sense they differ because individual subscribers assume their liability as individuals and they are not incorporated as companies. There are only four reciprocals active in property lines in Ontario.

4. *Lloyd's*²

Lloyd's is a market for insurance composed of numerous syndicates of individuals who are willing to insure risks. Lloyd's is situated in London, England but various brokers throughout the world have arrangements to bring insurance business to the Lloyd's underwriting syndicates. Lloyd's brokers act for prospective insureds in negotiations with individual underwriters or several underwriters in the case of a large syndicate. Brokers sign up several underwriters until the amounts they assume total the required insurance. Each syndicate is an individual insurer and Lloyd's as a corporation neither subscribes to policies nor directly issues them. A policyholder insures *at* Lloyd's but not *with* Lloyd's.

As indicated above, the majority of non-life insurance business in Ontario is written by stock companies. Stock companies operate with a dual responsibility—that is, responsibility to the interests of their owners and also to the interests of policyholders. The continuing ability of stock companies to provide insurance to meet future demands depends to a large extent on a satisfactory rate of return on owner investment that will encourage future capital additions.

1. Appendix E provides a description and a summary of the operating results of farm mutual insurance companies and Lloyd's.

2. *Ibid.*

2. Forms of Joint Underwriting

In addition to risks undertaken by individual companies, joint underwriting or pooling associations formed by two or more companies are an important factor in coverage for certain types of property and casualty insurance risks. Pooling arrangements are widely used in this Province in non-automobile lines to provide coverage in situations where one insurer is unwilling to assume the full risk—either because abnormal hazards are involved or because high property or liability values are at risk. Organization of insurers into various underwriting pools makes possible the utilization of industry resources for the transfer of those risks that might endanger an individual insurer's assets or profits.

In some cases, pooling is undertaken through formal organizations based on prior arrangements among insurers. In other cases pooling arrangements are organized by agents or brokers as part of their service in placing a risk.

Competition varies in the classes of insurance in which formal joint underwriting arrangements occur. For example, there is no competition for nuclear reactor business as a single international pool of mutual and stock companies, represented in Canada by the Nuclear Insurance Association of Canada, has been organized to provide world-wide capacity. On the other hand, there is vigorous competition among joint underwriting groups and other individual insurance companies for highly protected commercial risks (H.P.R. properties). Pooling associations concentrating on H.P.R. risks in Canada include the Factory Mutual System and the Canadian Industrial Risks Insurers.

In instances where individual risks may be too large, in terms of value or potential for loss, for one insurer to take, it is usual for the risk to be spread among several insurers by means of a subscription policy. A subscription policy is a less formal type of pooling arrangement whereby several insurers are solicited by an agent or broker to subscribe under one single insurance contract for a percentage of the total amount of insurance.

C. THE UNDERWRITING FUNCTION

In order to provide a viable insurance mechanism, the insurer must solicit policyholders to join in an organized risk-sharing group. Sufficient numbers of policyholders are needed so that the losses of a few can be spread among all members of the risk-sharing group at reasonable cost to each.

In soliciting policyholders, the insurer attempts, through risk selection, to build up a portfolio of policies that are profitable. In the risk selection process the insurer develops underwriting criteria for the risks he is willing to assume. For example, consideration is given to specifying perils or terms

in the insurance contract which reduce exposure to large unexpected losses. Underwriting guidelines specify the types of coverages or even types of customers for which the insurer is best able to evaluate the risk of exposure and therefore price for profitability.

Secondly, in organizing the risk-sharing group, the insurer collects and administers funds to cover future losses. In determining the amounts that must be collected to cover losses, the insurer assesses the probability of hazards occurring to participants in the group, he puts a value on the risk of loss and thereby determines the premiums to be charged.

A third function performed by the insurer in organizing the risk-sharing group is that of collecting sufficient funds from the company owners, from policyholders or from investments to cushion the company against insolvency and to form the basis for company growth. Because the evaluation of risk and the rate setting process may easily be upset by unpredictable losses, precautions against insolvency through reserves are required to protect both owners and policyholders.

The final major function in the organization of the risk-sharing group is the investment of reserve funds. The profit from investments can be used to expand the capital of the company, as described above, or it can be used on behalf of policyholders. The Committee recommended in its First Report that investment income should be considered “as an integral part of a company’s income and must be taken into consideration so as to reduce the total revenue an insurance company needs by way of premiums” and, in addition, that “insurers should be directed not to publicize their underwriting results as distinct from the results of their total operations, including any investment income”.¹

The financial overview in the preceding chapter pointed out that the underwriting and policy processing costs of property and casualty insurers were some five percent higher than in the case of automobile insurers.² The diversity of coverages in the non-automobile lines of general insurance would appear to prevent the underwriting process from having the same average potential for efficiency as in automobile insurance. However, it might be expected that personal property and automobile lines would bear a closer relationship in underwriting and processing costs than the 5.4 percent differential shown in the financial overview.³

D. MARKETING OF THE INSURANCE PRODUCT

1. Direct and Agency Writers

The insurer, in offering his insurance product to the customer must convey to him the essential features of his product, including the quality and

1. *First Report on Automobile Insurance*, page 94.

2. *Supra*, pages 41 and 42.

3. *Supra*, pages 41 and 42.

reliability of the product, the price and the extent and quality of service to be provided. In structuring his marketing or distribution system, the insurer looks for a system of marketing that fulfils some or all of the following aims:

1. best explains the product to various types of customers;
2. results in a profitable market share;
3. allows the insurer to compete on price;
4. allows the insurer to compete on service;
5. assists in successful promotion of the insurer's particular insurance products and services.

In carrying out these selling functions, the insurance company, under the present structure of the insurance system, deals either directly with the customer or through sales intermediaries.

Companies who prefer to write through direct solicitation of customers, as in the case of insurance written through mailed applications, or those companies who prefer to be represented by sales personnel who act exclusively for them, are called direct writers. Four of the largest direct writers¹ in *personal* lines—Allstate Insurance Company of Canada, Cooperators Insurance Association of Guelph, The State Farm Group and the Liberty Mutual Group represented 6.8% of the property and 4.7% of the liability direct premiums written in Ontario in 1977. In total, they represented only 5.9% of the direct premiums written in Ontario in 1977 in non-auto general lines. These same four companies represented 22.4% of 1977 automobile insurance premiums in the Province.

In total, they represented only 5.9% of the direct premiums written in Ontario in 1977 in non-auto general lines. These same four companies represented 22.4% of 1977 automobile insurance premiums in the Province.

The majority of insurance companies writing general insurance obtain their business from external intermediaries such as independent agents and brokers. These companies are sometimes called *agency writers*. Various theories abound regarding the evolution of writing through agents as a marketing practice. Most theories agree that the dominance of foreign general insurance companies in the past favoured use of local agents to penetrate the Canadian market. As general insurance is said "to sell itself", in contrast to life insurance which "has to be sold", general insurance may have been considered to be more amenable to marketing by an agency force removed from direct control of the insurance company. In addition, the diversity of general insurance lines and the inability of insurers to underwrite all risks re-

1. Other major direct writers include Constitution Insurance Company, The Personal Insurance Company, Allendale Mutual Insurance Company (commercial lines), Safeco Insurance Company and Scottish and York Insurance.

sulted in low individual company penetration in certain market areas and therefore made the training of company sales personnel to service these markets impractical.

Use of an external sales intermediary has both advantages and disadvantages for the insurer as well as for the customer. A primary benefit from the point of view of service to the customer is the ability to communicate better with the customer through an agent or broker who is resident in the local community and is knowledgeable about the insured's special needs.

The use of agents or brokers also benefits insurers by facilitating expansion of market share and sales in markets which are lightly populated or otherwise unable to support an exclusive or salaried sales representative. In addition, the insurer is not required to finance directly either the training, salaries or overhead of the agent or broker. Furthermore, the insurer is free to deal with only those agents or brokers who are both productive in bringing in business and are able to maintain a policyholder portfolio that is profitable. An agency supplying little in premium dollars can be dropped, eliminating the marketing and processing costs associated with the agency agreement.

On the other hand, the insurer may find it difficult to control the quality of service and promotion to the customer if these functions are performed entirely by intermediaries rather than by company trained and supervised sales staff. In fact, the insurer may fail entirely in stressing these functions by his reliance on the agent or broker to carry them out. The insurer may also find it difficult to minimize sales costs because the nature of the agency system tends to discourage variability in the rates of commission paid. Thirdly, the insurer may be unable to make full use of economies of scale in computerization, record keeping systems, specialization and so on because in many instances he must deal with small business units within the agency system rather than directly with the customer.

The trend in Ontario tends still to be in the direction of use of external agents and brokers as the preferred method of selling both automobile and other forms of general insurance. Although the direct writers appear to be increasing their market share, it is interesting to note that one of the direct writers, with a view to business in commercial lines, recently expanded into a mixed distribution system, combining sales through employee agents with sales through independent agents.

To some extent the following table, taken from a survey conducted by the Ministry of Consumer and Commercial Relations, appears to substantiate a pattern of buying insurance through the agency system. It should be noted that this survey was not designed to focus solely on consumer issues associated with the purchase of insurance, but included a wide variety of questions on a broad range of consumer issues.

BUYING HABITS FOR INSURANCE

How Bought	Percentage of Respondents Who Have	
	Auto Insurance	Home Insurance
Bought it from an agent*	63	69
Bought it direct*	37	31
Went through one person only	53	65
Were offered various alternative policies and prices	81	77

* Respondents may have had difficulty distinguishing between an insurance company salesman and an agent. Therefore these data must be treated with caution.

Source: Ontario, Ministry of Consumer and Commercial Relations, "A Survey of Consumer Issues Among the People of Ontario", August, 1978, pg. 24.

This table also illustrates that fewer consumers shopped around among agents or direct writers for the purchase of home insurance in comparison to automobile insurance. Most consumers indicated they were offered various coverage, deductible or price alternatives. It should, however, be noted that the Committee views the results of this survey with some caution, because the broad wording of the questions may not have provided respondents with a clear understanding of their intent.

In general, insurers in this Province still rely heavily on an agent or broker to solicit customers on an individualized basis. Among those insurance companies who market through the agency system, there appears to be competition for agents who place risks of a desirable nature. This factor makes it very difficult for the competing insurers to reduce marketing expenses by cutting commission rates.

The financial overview in the preceding chapter pointed out that the costs of the marketing or acquisition function of property and casualty insurers are some eight to ten percent higher than for automobile insurers.¹ The higher acquisition costs are attributed mainly to higher commission rates in the property and casualty lines which have remained largely stable, while commission rates in automobile lines have fallen in recent years.

2. Group Merchandising Approaches

Traditional approaches to marketing are based on the individualized agent-customer relationship—the agent being in some cases an employee and in others an independent intermediary. It is this traditional marketing approach and relationship that is examined throughout this Report. However, various other approaches to marketing exist and some have been implemented to a limited degree in this Province.

One example of an alternative marketing approach is direct solicitation

1. *Supra*, pages 41 and 42.

of customers through the mail, mass media or by telephone without an agent intermediary. This mass merchandising approach offers potential savings in marketing expenses and is sometimes suggested as a future growth area. However, it is not at present applied to property and casualty lines, except in limited situations, mainly because the insurance product must be relatively simple for direct mass merchandising to succeed. Moreover, it places an extra onus on the insurer to represent his product in the clearest and most understandable manner.

A further marketing approach that is receiving recent attention can be called *group merchandising*. Merchandising through group plans involves personal policy sales to common risk groups or to affinity groups such as employees in a common organization, union members or neighbourhood groups. The intention in this approach is largely to create savings in a two-fold fashion: first, to reduce premium costs by savings in marketing and policy processing expenses and, secondly, to offer savings in premiums by selling to controlled risk groups who are rated on their own loss experience. With regard to the first factor, significant savings can occur when the group already participates in a common administrative structure, such as a payroll deduction system, which then acts as a premium collection medium.

With regard to the second factor, if a group demonstrates lower average loss costs, because it is a lower risk group or participates in loss prevention measures, the overall premium for this group can be reduced. However, The Insurance Act¹ prohibits the charging of a lower rate for automobile insurance for any reason that results in a lower cost to an individual in a group, than he or she would have had to pay if insured individually. This restriction is not applied in non-automobile lines of insurance.

Group programmes are usually structured by an agent or broker who is familiar with the particular characteristics and needs of a class of customers and is therefore able to put together a package suited to their needs. Group plans may also be sold directly by an insurer who identifies a market segment in which he can apply a group marketing or rating approach that lowers premiums to group members—an example is that of the U.S. government employees originally served by G.E.I.C.O.

Distribution of group plans on a mass merchandising basis may lower premiums, but at the expense of reduced choice of coverage and possibly reduced service, particularly in the area of communication with the insured. To the extent that a comprehensive plan is offered and endorsed by an employer, employee association or other knowledgeable and trustworthy group, the consumer may be willing to dispense with certain individualized advisory services in order to benefit from a reduction in premiums.

A small number of personal line group plans have come to the Commit-

1. R.S.O. 1970, C224, S.363.

tee's attention. The Workers' Insurance Plan, providing automobile insurance and a homeowner's package, to the United Steel Workers of America, Local 6500 in Sudbury is one such plan which was proposed by a local agency and underwritten by the Traders General Insurance Company. The Harriott Homeowner's Plan, providing comprehensive replacement cost coverage to employees of companies who sign up for this programme, is marketed by a subsidiary agency of the Great West Life Assurance Co. and is underwritten by the Northumberland General Insurance Co. With the latter plan, Great West Life becomes the first Canadian life insurance company to enter into the personal lines sector of the general insurance industry.

At the present time, group marketing programmes are not regulated, although there is a provision for their regulation under the Insurance Act.¹ The Superintendent has issued guidelines with respect to the group marketing of automobile policies. These guidelines, issued on August 1, 1969, arose out of efforts of some automobile insurers to market on a mass merchandising basis. The guidelines, which are still in effect, are included as part of Appendix H to this Report.

The Association of Superintendents of Insurance of the Provinces of Canada recommended at its September 1978 meeting that the Superintendents continue to monitor group sales to determine what regulations might be needed to govern this marketing approach. The Association resolution calls for filing of *any* mass merchandising scheme to permit monitoring by the Provincial Superintendents. To date, the Committee is informed that no problems have been presented to the Superintendents and they report only a small increase in group or other mass merchandising activity.

E. CLAIMS SETTLEMENT

1. The Adjusting Function

The third major function of the insurer is to set up a mechanism to pay claims in the event the insured suffers a loss. The mechanism for settlement of claims must satisfy the insurer that payout on claims is minimized. Control over the cost of claims paid out benefits the insurer not only in terms of providing a greater margin for profit, but it also allows him to lower the price of the product making it more competitive. The policyholder should also benefit through reductions in the cost of his insurance coverage.

In addition, the mechanism for settlement of claims must satisfy the claimant that he or she has been fairly compensated. The role of the insurer in claims settlement is therefore to balance "good faith" in the fair compensation of losses with cost control in claims payout.

1. Section 95(3) of the Insurance Act provides that the Lieutenant-Governor-in-Council may make regulations "(c) governing group insurance contracts or schemes, or any class thereof including prescribing and regulating their terms and conditions, qualifications for membership in groups and regulating the marketing of group insurance contracts or schemes".

For the purpose of settling claims, the insurance companies normally employ experts who are either salaried company adjusters or independent adjusters operating as individual proprietorships, partnerships or incorporated companies. As indicated in the Committee's First Report, the tendency is for the salaried adjuster system to be adopted by the larger companies and in densely populated areas where it is practical for the company to take full advantage of any economies of scale that may be inherent in use of its own staff adjusters. On the other hand, independent adjusters are utilized by companies that are too small to justify the maintenance of their own claims departments, or where claims are to be settled beyond the convenient reach of salaried adjusters. In certain classes of general insurance, such as marine insurance, the choice of an independent adjuster is determined by the need to deal with a specialist in adjusting particular types of losses.

Some writers of general insurance in this Province handle claims almost entirely through independent adjusters appointed in those areas where they market. To some extent, the claims handling operation of these insurers is set up as a separate activity outside the insuring activities of the company. This practice is common for companies newly entering the field of property and casualty insurance. In these circumstances, the independent adjusters act like claims handling agents and may have authority to settle minor claims. The insurer relies on the competency and professionalism of these independent adjusters without the need for extensive supervision of their activities.

In general, under the present system of claims adjustment, the insurer hires the insurance adjuster to act as a specialist on his behalf in dealing with a claim. The insurer expects the adjuster to keep costs down for the company and for all its insureds by detecting and preventing improper claims.

The insurer also expects the adjuster to assist the claimant in filing a claim as part of the claims service aspect of the insurance product he sells. As the Carruthers' Insurance Studies in 1974 pointed out, an insured may need help with several tasks associated with filing a claim against an insurance company:¹

1. He must prove that there was a loss.
2. He must find out whether the loss was of a kind that the insurance contract covers.
3. He must estimate or evaluate the amount of the loss and how much of it the insurance will cover.
4. He must file a claim.

As part of his job function, the insurance adjuster provides assistance to the customer in these areas. The insurance adjuster is therefore hired by the in-

1. Report 3 on *Insurance Study*, Douglas H. Carruthers, Q.C., February 19, 1975, page 59.

insurance company to perform services for both the insurer and its insureds. As a result, the adjuster must balance the function of claims cost control for the insurer with fair claims settlement and assistance to the insured.

New approaches towards claims adjustment were illustrated in the Committee's Automobile Insurance reports, where the Insurance Bureau of Canada's Appraisal Centre concept and the government-run automobile Claims Centres in British Columbia, Saskatchewan and Manitoba were discussed. These approaches to claims adjustment permit insurers to exert some control over cost estimates for the repair of damaged vehicles. The government-run claims centres also provide a complete appraisal and settlement service to the claimant. However, for damage to property other than automobiles, there is no similar, collective industry approach to appraisal or claims settlement. This is the result of a much lower volume of claims and the oftentimes individualized nature of claims that do arise.

The Committee has been unable to obtain data which would allow it to estimate what portion of the premium dollar earned is spent by property and casualty insurers on claims adjusting expenses. In the First Report on Automobile Insurance, claims expenses were roughly estimated, based on periodic analyses conducted by the industry, at about 11¢ of every \$1.00 of automobile premium earned by the industry. Because of the greater number of product lines and the wide range in type and severity of losses in non-automobile general insurance lines, estimates of claims adjusting expenses are much more difficult to derive in this sector of the industry.

2. The Valuation Function

One of the most difficult tasks in claims settlement can be the valuation of the loss. For many claims an external estimate of repair or replacement cost must be obtained. In automobile claims, owners routinely are required to obtain repair cost estimates from two or more auto repair shops. In property claims, bids from two or more contractors are sometimes obtained in order to establish a value for the damage done. While the owner typically arranges for a repair cost estimate for auto claims, the adjuster rather than the claimant arranges for a valuation of the loss in most personal and commercial property claims.

The adjusting of property claims is complicated for a further reason: while the insurance contract may state the basis of damage payment as either actual cash value or replacement cost value, these terms can be ambiguous in certain instances and subject to judgment by the adjuster or appraiser. The expertise of the adjuster or appraiser in assigning a value to damages is therefore important in fair and reasonable settlement of claims.

Appraisal by an outside appraiser is often an important aspect of claims settlement. In any significant claim for property loss, for example where

damage exceeds \$5,000, or in any specialized loss such as loss of art objects, the adjuster will turn to an appraiser for valuation.

In addition, the statutory conditions specified in The Insurance Act regarding fire insurance contracts provide that in the event of disagreement as to the value of the property insured, the property saved or the amount of the loss, either party can demand an appraisal. The application of the appraisal process is specified under Section 102 of the Insurance Act and requires that each party bear equally the expense of the appraisal.

The appraisal process for the most part falls outside the regulatory control of the Superintendent and largely out of the control of the insurance industry since appraisal estimates are made by independent individuals or firms. Likewise, in the case of valuation of damages by estimate of two or more repair contractors, such as auto body shops, or roofing contractors, little is done directly by the insurance industry to control contractor practices that may lead to inflated cost estimates.

3. Arbitration in Claims Disputes

From the Committee's investigations, the number of disputes with respect to property and casualty claims appear to be very rare in relation to the total number of policies in force. Disagreements when they do arise can concern questions of fact, of amount or of liability under the policy.

The claimant who is in dispute with an insurer has three main alternative courses of action: accept the ruling of the insurer, go to court or proceed to arbitration. The first alternative will likely leave the claimant dissatisfied while the second may involve considerable time and money and may be avoided by the claimant on the premise that the insurance company has greater resources to employ in court cases. At the present time, the third alternative of arbitration is little used in insurance matters.

As described previously, Section 122 of the Insurance Act, pertaining to the statutory conditions of fire insurance contracts, provides that either party can demand an appraisal in the event of disagreement over the value of a loss. Section 102 which outlines the procedure for appraisal also provides for appointment of an "umpire" who arbitrates any differences between the appraisers chosen to settle the valuation dispute. If the appraisers cannot agree on an umpire, provision is made for selection by the courts. To this extent, there is some provision in the Insurance Act for arbitration in property loss claims.

One insurance company has, in addition, introduced an independent arbitration arrangement for its personal lines in order to satisfy the claimant that an independent, objective consideration has been given to his claim by a qualified arbitrator. This plan is intended to relieve the claimant of any perceived disadvantage in dealing with a large corporation with large resources

of time and money. In addition, some insurers have in recent years voluntarily drawn to the attention of their policyholders their right to appeal to an independent arbitrator when they have a legitimate complaint over a claim. They have moreover agreed to bear all reasonable fees and costs. Fees chargeable are outlined in regulations made under the Ontario Arbitration Act.

The Superintendent of Insurance in a submission before the Committee, endorsed a further proposal by the Arbitrators Institute of Canada, Inc., to extend arbitration to *all* insureds, as an alternative to unsatisfactory claims settlement or court action. At the present time, The Insurance Act provides for use of an “umpire” in valuation disputes only. It is suggested that, first, it would be more appropriate to use the term “arbitrator” instead of “umpire” in valuation disputes and also to refer to the process of deciding between representations from appraisers as an “arbitration”. Secondly, it is suggested that the arbitration process be made available for all variety of general insurance claims disputes including certain third-party cases and commercial claims.

F. OUTLINE OF THE RESPONSIBILITIES OF INSURANCE COMPANIES

Associated with the functions of the insurance company in transacting the business of insurance are certain responsibilities. The insurance company has legal, management and ethical responsibilities to:

- a) its owners,
- b) its policyholders,
- c) the intermediaries it deals with,
- d) the consumer at large,
- e) other insurance companies or the industry as a whole.

The insurance company’s responsibilities to its owners are legally defined in its articles of incorporation or association. At the same time it has management and stewardship responsibilities to operate in an efficient manner, as well as ethical responsibilities to represent fairly the interests of the owners.

Responsibilities to the policyholder are formally or legally defined in the insurance contract. The policyholder has the right to sue the insurer for breach of contract. But the policyholder in a competitive market is likely to expect more from his insurer than solely the acceptance of a legal obligation to assume risk. The policyholder will expect the insurer to show management responsibility that will (a) guarantee payment of claims, (b) provide as good or better service than available from competitors and (c) keep premiums sensitive to underlying costs and as low as possible without endangering solvency and service. In addition, the policy holder will expect the insurer to act responsibly in an ethical business manner, showing good faith

and adherence to sound business practices. The emphasis placed on these expectations by many policyholders is increased by the essential nature of property and liability insurance.

The insurance company also has a responsibility to the intermediaries it employs to carry out its sales and claims adjusting functions. As in the case of owners and policyholders, management has ethical responsibilities accompanying those legally derived from company/agency or company/broker agreements where they apply. These responsibilities go beyond those in typical company/agency agreements which, for example, require the insurer to indemnify and hold an agent harmless against liability to policyholders caused solely by company error in processing an agent's business.

The insurance company has a further responsibility to the consumer at large. The responsibility in property and casualty lines is not specifically set out in the licencing agreement or under The Insurance Act of the Province although the duties and obligations of insurers in motor vehicle claims are set out in Section 212. Nevertheless, responsibilities are spelled out in consumer laws such as the Consumer Protection Act and the Business Practices Act or in general corporation laws such as the Federal Combines Investigation Act which, for example, prohibits the practice of tied selling.¹

In addition, Sections 388 and 389 of The Insurance Act prohibit the insurance company, as well as other persons engaged in the business of insurance, from engaging in "any unfair or deceptive act or practice in the business of insurance". The remainder of Part XVIII of the Act gives the Superintendent the authority to determine whether such acts or practices have occurred and to order the person to cease engaging in his business.

Finally, the insurance company assumes a responsibility to its own industry. In Ontario and throughout Canada, many insurance companies have explicitly demonstrated their willingness to take on a collective responsibility through their association in the Insurance Bureau of Canada. The objects of the Bureau illustrate the aims of members towards better service to the public as follows:

- (a) To provide a forum for discussion on all matters in the field of general insurance;
- (b) To collect, collate and analyse actuarial and statistical and other information and to disseminate and make the same available with or without charge to any Member or non-Member of the Bureau;
- (c) To study legislation and legislative proposals;
- (d) To make representations as may be necessary through whatever seem to be appropriate channels;

1. Tied selling is defined in the Federal Combines Investigation Act as: "(a) any practice whereby a supplier of a product as a condition of supplying the product (the tying product) to a customer requires that customer to (i) acquire some other product from the supplier or his nominee, or . . ."

- (e) To engage in research and in so doing to carry out pilot programmes and projects with a view to providing a high level of service to the insured public;
- (f) To engage in public relations activities and to promote a better public understanding of the business of insurance;
- (g) To maintain high ethical standards and practices;
- (h) To assist Members in providing a high standard of services and economies to the insured public; and
- (i) To engage in all such other activities as are necessary or incidental or conducive to the attainment of the objects of the Bureau.

Members of the Insurance Bureau of Canada are representative of the total private property and casualty insurance industry in Canada. In the major non-automobile lines in Ontario, the Committee found that I.B.C. member representation based on 1977 membership and premium volume was 80% for property insurance lines and 85% for liability insurance lines.

The insurance companies in Ontario have also shown collective approaches to responsibility in other areas, such as loss prevention. The Insurers' Advisory Organization engages in surveying larger and technically more complex risks with loss prevention as an ancillary benefit and the Insurance Crime Prevention Bureaux undertake to combat insurance-related crime.

G. CONSUMER COMPLAINTS REGARDING GENERAL INSURANCE

To some extent, any failure of the insurance companies to carry out their responsibilities to the consumer should be reflected in complaints. There are several places where complaints can be registered: first, with the insurance company itself, either to staff people, executive officers or to a complaint department if such exists; second, with the Claims Committee or other appropriate Committees of the Insurance Bureau of Canada, should the policyholder or claimant be aware of the I.B.C. as an association of insurers; third, with the agent, broker or adjuster and their respective associations; for example, with the Insurance Information Bureau operated by the association of Independent Insurance Agents and Brokers of Ontario (I.I.A.B.O.); fourth, with the Office of the Superintendent of Insurance; and finally, with various other channels such as the Better Business Bureaux or newspapers and consumers' associations.

There is no publically reported information on the types of complaints directed by the public to individual insurance companies. I.B.C. has informed the Committee that it rarely receives complaints regarding personal and commercial lines of general insurance; these are in any event usually re-directed to the insurance companies involved or to the I.I.A.B.O.'s Insur-

ance Information Bureau. The I.I.A.B.O. reports that they receive a minimum of five calls a day but that complaints form only a small proportion of enquiries.¹ The I.I.A.B.O. has also commented that consumer complaints committees at the local level were most active about five years ago, but have since reported a drop in the number of consumer complaints received.

In addition to the seeming low level of complaints directed to the insurance industry, the Better Business Bureaux in Ontario and the Office of the Superintendent of Insurance report relatively small numbers and types of complaints regarding property and liability insurance matters.

In particular, the Better Business Bureau of Metropolitan Toronto, Inc. has made the following comments before the Committee:²

- “Our impression, before we started compiling statistics, was that insurance, and in particular general insurance (excluding auto), is an area in which the industry is doing a good job regulating itself. Our researchers have borne this out.”
- “The incidence of complaints in the area of all insurance excluding life is in the range of 1-1/3% of the total. If one considers only general insurance (excluding auto), the number of complaints diminishes to the point where it is not statistically significant.”
- “Based on the evidence we have been able to gather, it seems clear that the insurance industry is doing an excellent job of looking after any problems it may have with customers.”

Analyses of complaints received by the Superintendent’s Office at various times have produced the results shown in the following table.

COMPLAINTS TO THE OFFICE OF THE SUPERINTENDENT
REGARDING GENERAL INSURANCE—
DISTRIBUTION BY CLASS

Period Covered	Percentage of Total Complaints for Period			
	Auto %	Property %	Other %	Total %
1972	63	13	24	100
June 1976	57	15	28	100
April-June 1978	53	18	29	100

Source: Office of the Superintendent of Insurance.

The above data indicate a slight shift to increasing property and other lines insurance complaints when measured against a relative reduction in the

1. Most common complaints (both in automobile and general lines) include: a) rate increases: following an initial flurry when rate increases are announced, calls tail off to two or three per month; b) unsatisfactory claims settlement, average eight calls per month; c) delays in processing changes and correspondence responding to enquiries, not exceeding two calls per month; d) misunderstanding about coverages and exclusions, very few; e) inaccuracies in policies, bills, etc., very limited; f) misunderstanding about deductibles, more frequent in the past two years.

2. Better Business Bureau of Metropolitan Toronto Inc., Paul J. Tuz, President, Letter to Mr. James R. Breithaupt, Q.C., M.P.P., November 15, 1978.

level of complaints in the automobile category. The high public profile of automobile insurance may have led the industry to increase its emphasis on resolving problems, thereby reducing the relative level of automobile complaints.

As the level of overall property insurance complaints is about one-third that of automobile insurance complaints, the above data cannot be properly assessed without recognizing the comparative number of policies in force and the volume of claims. For example, data available to the Office of the Superintendent of Insurance indicate that while the number of property type insurance policies in force may be as high as 67% of the number of automobile insurance policies, the number of annual property insurance claims is about 54% of the automobile insurance claims.

Further analysis by the Department shows that the level of complaints regarding claims would appear to be similar in both classes of insurance when allowance is made for a comparative number of policies in force. Property insurance complaints regarding rates and other matters fall below the frequency experienced in automobile lines.

The following table shows the comparative distribution of property and automobile insurance complaints by type of complaint.

COMPLAINTS TO THE OFFICE OF THE SUPERINTENDENT
REGARDING THE GENERAL INSURANCE—
DISTRIBUTION BY TYPE OF COMPLAINT

Complaints Related to	Percentage of Total Complaints	
	Property %	Auto %
Claims	61	39
Rates and Underwriting	24	44
Other	15	17
Total	100	100

Source: Office of the Superintendent of Insurance.

In general, there are many fewer complaints regarding property insurance matters than automobile matters. In another survey, 43 percent of respondents indicated that in their opinion it is very difficult to get car insurance claims settled fairly.¹ Likewise in the property class of insurance, the predominant complaints are those regarding claim matters.

1. Ontario, Ministry of Consumer and Commercial Relations, "A Survey of Consumer Issues Among the People of Ontario", August, 1978, page 19.

CHAPTER 5

Roles and Responsibilities of Intermediaries in the General Insurance Industry

A. INTRODUCTION

This chapter follows upon the previous description of the marketing function and the claims settlement function that form part of the insurer's responsibilities, by examining in further detail the roles of the various types of sales and claims adjusting intermediaries engaged by insurance companies to market and deliver their product. The first part of this chapter is concerned with agents, brokers and insurance consultants, followed in the second part with a discussion of the various types of adjusters and other participants involved in expediting claims settlement.

The overview in this chapter is organized under the following headings:

- Intermediaries in the Marketing Process:
 - agents
 - staff sales personnel
 - insurance brokers
 - insurance consultants
 - duties to insurers and consumers
- Changes in the Roles of Responsibilities of Sales Intermediaries
- Intermediaries in the Claims Adjustment Process:
 - agents or brokers
 - independent or proprietor adjusters
 - company adjusters
 - public adjusters
 - others involved in claims settlement
 - responsibilities to the consumer regarding the claims adjustment process.

This chapter reviews the findings of the Committee in its first two Reports on automobile insurance and supplements these findings with additional observations based on its study into the property and casualty sector of the general insurance industry.

B. INTERMEDIARIES IN THE MARKETING PROCESS

Throughout its enquiry into the general insurance industry, the Committee has been impressed with the importance of the purchase function in ensuring future consumer satisfaction with the insurance product. As the Committee stated in its First Report, "it is desirable that the personnel at the

point of purchase are knowledgeable and helpful to the public so that decisions about the choice of coverage can be made intelligently".¹

In this section the Committee proposes to re-examine the structure of the *traditional* distribution system for general insurance, in light of recent proposed amendments to The Insurance Act dealing with agents and brokers. This section deals primarily with defining the relationships of sales intermediaries to insurers and to the public and with the responsibilities associated with these relationships.

It is important to repeat that there are recent indications of growing interest in non-traditional methods of distribution, such as group merchandising, wherein the duties of sales intermediaries may be differently defined from those considered in this section.

As outlined previously, insurers in this Province, under the current system of licencing and distribution set out in The Insurance Act, solicit or receive business from different types of sales intermediaries: independent agents, exclusive agents, staff sales personnel and brokers. The purchasers of insurance, given their needs for assistance in the selection of an insurance product, tend to approach the insurance purchase by selecting, as the first step, an intermediary appropriate to their needs for assistance or advice. Choice of insurer and selection of the appropriate insurance contract are typically secondary to the choice of intermediary.

The basic functions performed by the sales intermediary for the purchaser include:

- (a) identifying the risks to be insured;
- (b) evaluating or measuring the risks;
- (c) reviewing, evaluating, recommending or advising on contracts of insurance; and
- (d) transmitting applications for a policy or negotiating contracts of insurance with insurers.

The purchaser may, however, elect to pay a fee to a person other than a sales intermediary to carry out the first three functions outlined above, thereby dealing with an insurance "consultant" who does not actually place the risk for him.

Following are definitions of the various intermediaries involved at the point of purchase of the insurance product, as established under the current distribution system. It is estimated that there are some 12,500 agents, brokers and their employees engaged by the general insurance industry in Ontario.

1. *First Report on Automobile Insurance*, page 211.

1. Agents

Sales intermediaries who are licenced under Section 342¹ of The Insurance Act are permitted to carry on business as insurance “agents”. “Agents” solicit insurance on behalf of an insurer or transmit applications for an insurance policy to and from such insurer, or offer or assume to act in negotiation of an insurance contract or its renewal. At the beginning of 1979, records kept by the Office of the Superintendent of Insurance indicated that there are 8,500 licenced agents in total in this Province.

All agents must be sponsored by at least one insurer through a continuing agency agreement. The agency agreement usually outlines the categories of risk which may or may not be bound by an agent or for which no commitment can be made on behalf of a company by an agent without the express permission of the company. Without an agency agreement, one ceases to be an agent. Any insurer can refuse to grant an agency agreement.

Agents are paid a commission out of the premium received, as identified usually in addendums to the agency agreement. In automobile lines, the commission is generally in the area of ten to fifteen percent of the premium; in property lines, the commission falls in the area of twenty to twenty-five percent and is variable for the other lines of property and casualty insurance. Volume or performance incentives may also be included in the commission rate structure.

Based on the type of agreements reached with insurers, agents are divided into two major categories: “independent” agents and exclusive agents.

(a) “Independent” Agents

“Independent” agents represent one or more insurers through a *non-exclusive* agency agreement. The “independent” agent operates solely on a commission basis and maintains his own office separate and apart from any insurance company.

The Committee in its First Report came to the conclusion, with dissenting opinions, that “the use of the term ‘independent’ agent is clearly ambiguous in that it may leave the impression that the agent is acting on behalf of the applicant for a policy, whereas in fact he is really obligated in law to act as agent for the insurer or insurers whom he represents”.² The Committee therefore recommended “the abolition of the term “independent” or any word of similar connotation so as to avoid any implication that those who are currently designated as “independent” agents are representatives of the

1. In addition, Section 342(20) provides for regulations prescribing conditions for granting or renewal of licences, regulating the method of handling premiums, requiring agents to supply information and other matters pertaining to their business. Regulation 539 referring to licences of insurance agents contains the current regulations.

2. *First Report on Automobile Insurance*, page 216.

consumer when they are in reality representatives of the insurance companies''.¹

(b) Exclusive Agents

Exclusive agents deal with one insurance company for whom they act as agents on the basis of an *exclusive* agency contract. Exclusive agents may in fact be employee agents of the insurer, soliciting business on the basis of an agreement which provides both salaries and commissions as remuneration. The commission paid to exclusive agents may be less than that paid to the "independent" agent, since the company they represent may assume some part of their overhead and other expenses.

Unlike "independent" agents, where the customer list belongs to the agent, if the exclusive agent discontinues his association with the insurer, he forfeits his right to the business which is transferred to another agent of the company.

The role of the exclusive agent is clearly that of a salesman for an insurer, and he is likely to be perceived as such by the insured.

Agents who maintain their own separate offices and deal with two or more insurers on a non-exclusive agreement basis are eligible to be associated with the Independent Insurance Agents and Brokers of Ontario (I.I.A.B.O.), an organization which is one of eleven members of the Canadian Federation of Insurance Agents and Brokers Associations. Since organization in 1920, the association has grown to a membership at July 12, 1978 of 3,089 agents in 1,237 agencies, out of a possible 3,839 agents eligible for membership. Included at that date were 50 individuals with brokers licences out of a total 117 brokers eligible for membership. I.I.A.B.O. members represented about forty percent of the 7,549 licenced agents in the Province in mid-1978. The remainder were either non-members, some of whom were part-time or inactive, or were agents for only one insurer and thereby were not eligible to join. There were 3,710 licenced agents who fell in the latter category.

Although I.I.A.B.O. represents some three-quarters of "independent" agents, it is still not representative of all agents to permit reliance on its activities as the sole means of supervising the conduct of all participants in the marketing or acquisition process.

2. Staff Sales Personnel

Staff sales personnel act on a full or part-time basis for one insurer exclusively. Staff sales personnel are not required to be licenced by the Superintendent of Insurance, although the actions of their company are regulated by The Insurance Act. Staff sales people are trained by the insurer and carry

1. Ibid., page 216.

out their responsibilities under relatively close supervision by the insurer. The remuneration received by this sales group may include "commissions" on a fixed or percent of premium basis, as well as salaries.

Many direct writers differentiate between those sales people who solicit business and those who complete applications for individuals. For the most part, they encourage or require those who solicit business to become licenced as agents, exclusive to their company.

In the First Report, the Committee considered the advisability of amending the Act so as to provide that staff personnel who are engaged in the sale of automobile insurance should be licenced, just as agents and brokers are. The Committee, however, concluded that this step was unnecessary in view of the fact that if such personnel act improperly, sanctions can be imposed directly on the insurance company that employs them.¹

3. Insurance Brokers

Insurance brokers, by definition under The Insurance Act, place insurance with an insurer rather than solicit for an insurer. The Act states that they should not be presumed to be either the agent of the insurer or the agent of the insured. Unlike agents, brokers are not required to be sponsored by an insurer.

However, letters of intent or management contracts are normally signed between an insurer and licenced broker, primarily with regard to personal lines. Brokers seek to deal with insurers who will accept a spread of risks and who will give them underwriting or binding authority, claims settlement authority for first-party claims, and the right to assign an appraisal or adjusting firm in the event of a loss.

Brokers are licenced, under Section 344 of The Insurance Act, but do not fall under the regulations governing agents. Section 346 of the Act provides for special licences for brokers doing business with unlicenced insurers. At August 2, 1978, 117 individuals were licenced as brokers in Ontario; these 117 individuals were associated with 23 brokerage firms. By early 1979 the number of brokerage firms had expanded to about 50. Only a relatively small number of licenced brokers are required within each licenced insurance brokerage company, as the administrative and other functions of a brokerage firm can be carried out by non-licenced persons, so long as a licenced broker is managing the solicitation and placement process.

The services offered by brokers may be no different than those offered by the agent who analyzes the insured's needs and evaluates competitive insurance contracts. The broker, however, represents himself as serving the insured and acting exclusively on the insured's behalf in dealing with insur-

1. *First Report on Automobile Insurance*, page 215.

ance companies. As a result, the broker's actions as well as those of the agent are governed by liability under common law.

Brokers tend to be organized in large brokerage houses capable of arranging the more complex, specialized forms of commercial insurance coverage as well as the more common general policies, such as automobile or homeowner's insurance.

Brokers are usually paid by means of a commission based on a percentage of the premium, in the same way as the agent. The commission is ordinarily deducted as funds are received from the client for transmission to the insurer. Occasionally, but less frequently, the broker may be paid a fee for insurance placed. Contingent profit commissions are also available for some lines. Historically, the percentage of premium paid by an insurer has not varied among contracts of the same kind, although the type of business handled by brokers has encouraged negotiation of the brokerage commission on some insurance contracts. The method of payment of commissions, combined with a number of services performed for the insurer by both agents and brokers, can give the appearance that brokers act for the insurance company.

In the First Report the Committee agreed that "the term "broker" should be reserved exclusively for the use of those who elect to represent insurance buyers only, and who do not directly represent insurance companies, even though their commissions may be paid out of premiums which they collect and remit to the insurer".¹

4. Insurance Consultants

Insurance consultants are not sales intermediaries in that they do not place insurance with an insurer. They are not at present defined or regulated under The Insurance Act. The following comments deal with those insurance consultants who are independent in the sense that they have no interest in any insurance agency, brokerage, or adjustment firm nor they in him. Mr. Justice Carruthers in his *Insurance studies* stated:

"Two characteristics the public expects in a consultant are:

1. A degree of independence and an absence of monetary incentive for the consultant to advise his client in one direction or another.
2. A level of skill adequate to the task."

Unlike agents and brokers, consultants do not carry out any duties on behalf of an insurance company. The consultant in the property and casualty field of insurance works for the insured, assisting in risk management, selection of brokers and insurers, loss adjustment and a wide range of other tasks, complementing the work of agents, brokers and the client's insurance

1. *First Report on Automobile Insurance*, page 215.

manager. Fees charged by Canadian consultant firms are on the basis of a time charge or retainer and none of the firms charge contingency fees, although some firms in the U.S. do. Because of the cost of their services, consultants are generally retained by large corporations or associations either to replace or complement their own experienced officers in dealing with the well qualified personnel of major brokerage firms.

There would appear to be only about half a dozen independent Canadian insurance consultant firms.

5. Duties to Insurers and Consumers

With the exception of insurance consultants, each of the intermediaries described above carries out duties both on behalf of the Insurance company and on behalf of the consumer. The agent or broker is usually required to perform a number of functions for the insurer with whom he places a risk, including:

- completing an application or renewal satisfactory to the insurer;
- inspecting the risk and obtaining information on the hazards involved;
- securing an evaluation of the current value of physical assets and exposure to loss; and
- collecting the premiums and remitting them to the insurer.

The methods or functions performed vary to some extent between personal lines coverages and commercial coverages, as well as among classes of insurance.

Both agents and brokers perform these functions for insurers, although the broker is not deemed to be an agent of the insurer. There is no separate compensation from insurers directly corresponding to the variety or number of services performed by agents and brokers on the insurer's behalf.

In the case of agents, the agency/company agreement extends authority to the agent to issue policies in accordance with specific instructions established by the insurer. Although the duties of the agent explicitly defined in the agency agreement refer chiefly to transaction procedures, the agreement can be terminated if the agent fails to carry out his broader responsibilities to the insurer and the customer. In the case of brokers, the brokerage/company agreement does not establish a duty to act on behalf of the insurer.

Agents and brokers also perform functions which they believe are in the best interests of the consumer. The Association of Independent Insurance Agents and Brokers of Ontario outlined many of these functions in a submission to the Committee. They include:¹

1. advising the client on the minimum amount of insurance it would be prudent to place on a home or commercial property;

1. Independent Insurance Agents and Brokers of Ontario, Submission to the Select Committee on Company Law, August 2, 1978.

2. advising the insured of the coverage provided by the insurer;
3. providing counsel as to the kinds of insurance which will meet the client's needs;
4. selecting a market (or markets in the case of subscription placements) which in the agent's or broker's opinion will satisfactorily serve those needs;
5. either computing or negotiating the premium cost with the insurer;
6. collecting the premium and frequently arranging for its financing to suit the client's particular situation;
7. receiving notification of changes and arranging for adjustment of the coverage when necessary;
8. being available for counselling as to the extent or applicability of coverage should the client enquire;
9. receiving notices of claims and reporting them to the insurer or appointing an adjuster, or both depending upon the agent's status;
10. keeping the client informed of renewal date and reviewing coverages;
11. following up on reported claims to ensure the client's interests are being attended to promptly and properly; and
12. providing identifiable premises and holding himself out as an insurance agent or broker at his own expense.

Section 388 of The Insurance Act prohibits the agent or broker from charging a fee to the consumer for these services when he already receives remuneration based on the premium charged for the policy.

The duties of the agent or broker to the consumer are not specifically defined in legislation at the present time, although, under The Combines Investigation Act and the Ontario Consumer Protection Act, it is a criminal and civil offence to disseminate improper insurance information or to fail to communicate pertinent or proper information. The degree of advice and assistance provided by the sales intermediary is largely a matter left to his own discretion, given that the courts have recognized, under common law, a legal responsibility for a duty of due care to the insured.

In advising a client regarding his insurance needs, the agent or broker sometimes finds that the client refuses to accept the complete insurance programme as recommended. There is concern that the agent or broker should demand from his client, particularly from commercial clients, a formal refusal of those parts of the programme eliminated. This demand is meant to eliminate any legal responsibility imposed on the broker in the event of a loss suffered by the client which is not covered under the insurance programme.

C. CHANGES IN THE ROLES AND RESPONSIBILITIES OF SALES INTERMEDIARIES

Confusion in the minds of the public and the industry, about the role and responsibility of intermediaries in the business of insurance, has been identified by Mr. Justice Carruthers in his 1973-1975 *Insurance Studies* and by the Committee in its *First Report on Automobile Insurance*. Prompted by this confusion, amendments to The Insurance Act have recently been proposed by the Minister of Consumer and Commercial Relations and the Office of the Superintendent¹ to provide for a redefined distribution system. The proposed amendments provide for a system composed of "incorporated brokers" and "general lines agents", the latter group holding themselves out to the public as representatives of those insurers for whom they have an authority to act. Staff sales personnel are not covered by the proposed amendments and would not need to be licenced.

A major objective of the proposed amendments is to establish a clearly identifiable intermediary system and to specify the rights, duties and responsibilities of the intermediary to provide a level of service that meets the demands of the consumer.

At the present time, the responsibilities of the agent or broker to the insurers and to the public are defined either in contract, where agency/company agreements exist, or, more generally, in common law. As mentioned above and outlined in the First Report, a legal responsibility of the agent to the insured has been recognized in the courts.

"In *Fine's Flowers Ltd. v. General Accident Assurance Co. of Canada et al.* (1975) 5 O.R. (2d) 137, at page 143 ff., the Honourable Mr. Justice Fraser found that it is wholly unrealistic to say that an agent is acting gratuitously where the insured, who is getting insurance from him, is relying on his advice as to the company in which to insure, the coverage and particular type of policy and where the insured is paying a substantial premium from which the agent is to be paid his commission. He accordingly found that such an agent owed a duty of due care and skill to the insured and imposed liability upon the agent where there had been a failure to fulfil that duty."²

The proposed amendments to The Insurance Act would, however, for the first time, prescribe in the Act statutory duties of care of a general lines insurance agent to those insurers for whom he or she acts and to the public. These statutory duties of care are as follows.

1. With respect to the insurers with whom he has a contractual arrangement to act, "a general lines insurance agent shall,

1. Ministry of Consumer and Commercial Relations, Office of the Superintendent of Insurance, "Proposal for Amendment to Part XIV of The Insurance Act—Agents, Brokers and Adjusters", November 1977.
2. *First Report on Automobile Insurance*, page 211.

- (a) exercise, carry out and discharge his duties and responsibilities honestly and in good faith,
- (b) not engage in any other work, occupation or activity which interferes with his principal occupation as a general lines insurance agent and from which he receives, directly or indirectly, any compensation,
- (c) act in the best interests of the insurers he represents, and
- (d) at all times be deemed to be the agent of the insurer and not the agent of the insured.”¹

2. “A general lines insurance agent shall, with respect to the public,
- carry on business and hold himself out as a representative of those insurers with whom he has a contractual arrangement to act,
 - acting at all times to the extent of his authorities in an honest and prudent manner, and
 - shall advise those members of the public with whom he deals of the types and extent of insurance coverages available through him in the best interests of the insured or proposed insured.”²

As a result of such amendments, companies who sponsor general lines agents would have to accept a much greater explicit responsibility for their activities.

In the matter of brokers, proposed changes to the Act would encourage the development of a broker as a consultant to the public on insurance matters. The intention here is to provide a skilled, competent person capable of handling the insuring needs of the consumer. The responsibility of the broker to his client will continue to be defined under common law.

Brokers will be required to carry on business to the exclusion of all other businesses and occupations and act at all times in good faith in the best interests of the public they represent. It is also proposed that, when presenting a statement to a member of the public, any broker who is remunerated by an insurer must disclose in writing the amount paid or payable by the insurer. This amount must be deducted from the fee payable to the broker by the member of the public.

Brokers will continue to be licenced under The Insurance Act. They will be required to certify to the member of the public for whom they act that insurance coverage has been placed and must identify the name of the insurer with whom the coverage was placed.

Brokers will also be able to negotiate for a binding authority with an insurer in order to speed service to the public. This latter point was of some concern to witnesses before the Committee representing the Ontario Risk and Insurance Management Society.

1. Proposal for Amendment to Part XIV, *op. cit.*

2. *Ibid.*

The Committee in general endorses the government's efforts, with these proposals, to clarify the rights, duties and responsibilities of insurance intermediaries. The need for such clarification is equally apparent in the automobile insurance and in the property and casualty insurance field. In fact, in many lines of property and casualty insurance, the consumer's need for assistance and advice is far greater than with respect to automobile insurance. Accordingly, in the Committee's opinion, there is a need for a comprehensive definition of the roles and allegiances of intermediaries in the insurance process in order to provide for an adequate level of consumer service and protection.

D. INTERMEDIARIES IN THE CLAIMS ADJUSTMENT PROCESS

Tangible delivery of the insurance product occurs only when the insured suffers a loss and a claim must be paid. This section outlines in greater detail the roles of the various specialists and other persons engaged in the claims settlement process and their relationship to the claimant. In addition to further discussion of the roles of independent and company adjusters, descriptions of the roles of agents and brokers, public adjusters, foreign adjusters and claims agents are included.

1. Agents or Brokers

The Carruthers' studies on insurance pointed out that most claimants approach their agent or broker first in the matter of claims settlement. Carruthers stated that "from the point of view of the buyer of insurance, the purchase of an insurance contract and the settlement of a claim are not separable problems".¹

The agent's or broker's main role in claims settlement is to expedite a prompt and fair settlement between the insurer and the claimant. The agent is prevented under The Insurance Act from negotiating or settling losses. However, he can do anything that will assist but not interfere with the handling and progress of the adjustment.

In most cases, the agent or broker turns claims reported to him over to the insurance company. He may be required to fill in a preliminary report concerning all details of the incident including time, date, place of loss, extent of damage, injuries and so on.

In some cases, agents or brokers may be authorized by the insurer to pay small or uncomplicated losses, particularly in personal property lines. For example, some agents or brokers have draft authority from certain of the companies they represent to make payments on first-party claims up to a pre-determined amount. Claims supported by a receipt for repair or replace-

1. Report 3 on *Insurance Study*, Douglas H. Carruthers, Q.C., February 19, 1975, page 63.

ment where there is no argument over quantum are often treated in this manner. In many instances of small claims, companies will not assign an adjuster unless the damage is in excess of \$500 and will instead expect an agent to assist in settling the claim. The agent in these cases does not actually adjust the claim as the event of loss is readily substantiated and the amount of damage is easily evaluated.

Most insurance brokerage companies maintain a claims department to advise clients on matters pertaining to their loss settlement. They may in certain loss situations advise or assist their clients in establishing the value of damages incurred to be compared with the insurer's estimate or offer of a settlement amount. In addition, most brokers seek authority from the insurers they deal with to assign an independent adjuster to the claim as a means of expediting the claim. Brokers also seek claims settlement authority to pay for minor repair costs on first-party claims. They sometimes use their own funds to make the payment as a service to the customer and then collect from the insurer.

In general, notice to the agent regarding a loss has the same legal effect as notice to the insurer. However, the agent is not reimbursed directly by either the insurer or claimant for his assistance in handling or forwarding a claim, although he may be performing a number of functions for both of them: collecting information on the claim, notifying the claims department of the insurer, recording the name of the adjuster assigned to the claim, and prompting the insurer for quicker claims settlement. While the agent has an interest in seeing that his client receives prompt and fair treatment in the loss payment, he has no direct financial remuneration for providing claims handling assistance.

2. "Independent" or Proprietor Adjusters

As described in the previous chapter, insurers employ adjusters as experts or specialists to act on their behalf in negotiating and settling claims. *"Independent" or proprietor adjusters* carry on operations independent of the insurance companies as individual proprietorships, or partnerships or as incorporated companies. "Independent" adjusters are licenced under The Insurance Act for three classes of licence—automobile, fire and casualty. The granting of a licence to an "independent" adjuster is subject to the completion of a course of apprenticeship and the passing of examinations that lead to either a full licence or a limited, qualified licence.

Each "independent" adjusting agency is retained on a case-by-case basis by the insurance companies it deals with. Proprietor adjusters are therefore dependent on the insurers for their compensation and for continued business.

Records in the Superintendent's Office indicate that there were approximately 1,000 "independent" adjusters in Ontario in early 1979, compared

to about 1,300 two years ago. Most but not all are licenced to adjust property claims. "Independent" adjusters appear to be specializing more in larger or complex property losses and more in providing service to the smaller communities in the Province. Automobile claims adjusting by the "independent" adjuster has shown the greatest decrease in the general insurance field with the greater use of company adjusters, telephone adjusting and drive-in appraisal centres.

A few, but only a few, "independent" adjusters have authority from insurers to issue settlement drafts to the insured. On the other hand, the majority of company adjusters have the authority to issue claims payments up to a specified amount. Settlement authority is rarely extended to "independent" adjusters because they are retained for individual assignments on a fee-for-service basis and the insurer has little control over their handling of funds. In any case, the payment draft issued by an "independent" adjuster may not be any quicker a method of payment, because it still involves substantial processing time as a copy of the draft must be sent to the insurer before he advises his bank to honour the draft.

The Committee in its First Report expressed concern that "self-employed adjusters cannot be considered as being "independent" of the insurance companies who retain them".¹ The Committee added its concern that "members of the public may be misled into supposing that adjusters exercise a function similar to that of arbitrators or judges who make independent decisions relating to the claims with which they deal".² Accordingly, the Committee recommended, with dissenting opinions, that the Act be amended where necessary so as to prohibit the use of the term "independent" as a description of adjusters.³

The Committee's conclusion regarding the dependence of the "independent" adjuster on the insurance company who retains him, also led it to question the advisability of the present licencing system. The Committee, in the context of its review of automobile insurance, considered the insurance company on whose behalf an adjuster operates, even on a case-by-case basis, to be entirely responsible for the adjuster's conduct.⁴

3. Company Adjusters

Company adjusters are full-time employees of insurance companies, employed to carry out the claims adjustment process for them. Salaried adjusters are not subject to licencing by the Superintendent. Each insurance company has its own qualifications, standards and training programmes for staff adjusters. The majority of company adjusters have unequivocal author-

1. *First Report on Automobile Insurance*, page 134.

2. *Ibid.*

3. *Ibid.*, page 135 and page 137-8 for the dissents.

4. *Ibid.*, page 135.

ity to issue draft settlements up to a specified limit which may be as high as \$25,000 for some adjusters.

Although there are no records regarding the numbers of staff adjusters in this Province, it has been estimated¹ that some 4,000 to 5,000 persons are employed in an adjusting capacity in the claims departments of insurers. Many today are telephone adjusters, handling claims from an insurer's branch office rather than working "out in the field". In addition, companies have "claim examiners" who process claims, but are not involved in adjustment.

The Committee in its First Report noted the salaried adjusters were entirely free of the jurisdiction of the licencing system, while current trends appeared to indicate an increase in the numbers and use of salaried adjusters. Nevertheless the Committee was satisfied that acceptable standards of claims adjustment could be maintained by exercise of the normal supervisory authority of the Superintendent over the insurance company, who should therefore be held entirely responsible for the conduct of its adjusters.

The Committee, in the context of automobile insurance, concluded that the conduct of employee adjusters need not be regulated through the current complex system of licencing.²

4. Public Adjusters

Public adjusters are licenced by the Superintendent to act for insureds or claimants on property losses. They cannot act for an insurer. They are retained therefore by the claimant to assist him in settlement of a loss with the insurer. For the most part they assist in proving that there was a loss, in estimating or evaluating the amount of loss, as well as assisting in filing a claim.

The Insurance Act prohibits any adjuster negotiating for or advising insureds on automobile claims involving either bodily injury or damage to property. This provision would appear to be designed to prevent "ambulance-chasing" in motor vehicle claims but the same prohibition has not been extended to other property and liability claims.

Use of the public adjuster to serve insureds in the settlement of claims is a means of introducing equal expertise to both sides of the claims settlement process. However, widespread need for public adjusters would add increased costs of the settlement process, payable by the claimant, and could be avoided by the continuing efforts of insurers to resolve claims matters quickly and reasonably.

There are only two public adjusters in Ontario today. To some extent,

1. Ontario Insurance Adjusters Association, Submission to the Select Committee on Company Law, July 26, 1978.

2. *First Report on Automobile Insurance*, page 135.

the fee involved in retention of a public adjuster by a claimant restricts widespread use of public adjusters, particularly in personal lines settlements. While commercial clients are more likely to afford the services of a public adjuster, they are often able to obtain similar services from a larger agency or brokerage firm, without payment of a fee.

5. Others Involved in Claims Settlement

Foreign adjusters are retained by insurers to come into the Province for the purpose of adjusting individual claims. Adjusters not resident in Canada or in Ontario are beyond the supervision and control of the Office of the Superintendent. In some cases, the foreign adjuster represents an unlicensed insurer so that supervision by the Superintendent over the insurer is also lacking. The use of foreign adjusters is of particular concern in non-automobile general lines where certain specialty or high-risk exposures may be insured with unlicensed insurers.

The Committee in the First Report recommended amendment of The Insurance Act "to provide that no insurance company shall engage a foreign adjuster to handle a claim in Ontario without the consent of the Superintendent".¹ The Committee also recommended that the Act be amended to prohibit corporations from acting as adjusters if they are controlled by non-residents of Canada.

Claims agents operate mainly in the area of marine insurance. Insurers domiciled overseas who are without Canadian facilities rely on a Canadian resident claims agent for handling mainly marine cargo claims. The authority delegated by insurers to a marine claims office varies from authority to settle claims on the insurer's behalf to appointment of a claims office to act solely as a survey agent. The function of a survey agent is to make a survey of the loss, which may in some cases be sold to the claimant who must mail it to the overseas insurer himself for ultimate acceptance or rejection.

In the field of marine liability, "Protection and Indemnity Clubs", which are associations of shipowners acting like mutual insurance companies, control all claims. All are domiciled overseas and are usually represented in Canada by legal offices which appoint local marine surveyors to work for them in the field.²

Marine claims agents or survey agents are not regulated under The Insurance Act. However, many claims agents in Ontario are also independent adjusters licensed for other lines of general insurance and therefore fall under the authority of the Superintendent.

1. *First Report on Automobile Insurance*, page 136.

2. R. Duncan Macfarlane, "The Marine claims business in Canada", *Canadian Insurance*, February 1978.

6. Responsibilities to the Consumer Regarding the Claims Adjustment Process

The duty of care of the adjuster to the claimant is not as comprehensively defined under common law as that of the agent or broker. The adjuster or claims processor can be held legally liable for negligent conduct as can the agent. However, the claimant does not rely upon the advice of the adjuster in the same manner as that of the agent, nor does the adjuster receive his payment for claims service directly from the premium paid for coverage. In fact, the statutory conditions of the insurance contract require that the insured submit a proof of loss and produce all records pertinent to the valuation procedure. The adjuster in a sense acts as an intermediary in transferring this information to the insurer and negotiating on the insurer's behalf.

The conduct of adjusters towards claimants is referred to in Part XVIII of The Insurance Act. This part of the Act deals with unfair and deceptive acts and practices in the business of insurance. Under Section 388, nine such acts or practices are set out ending with prohibition of "any consistent practice or conduct that results in unreasonable delay or resistance to the fair adjustment and settlement of claims". The Committee in its consideration of adjusting in the automobile insurance industry recommended that Section 388 be amended to remove this general list of improper acts and practices.¹ It then recommended that authority should be given for the making of regulations more specifically defining unfair acts and practices in the process of claims adjustment, as well as generally in the business of insurance. The Superintendent of Insurance should then assume leadership in evolving a Code of Conduct in such fields as claims adjustment.¹

The preceding review of the various participants in the claims adjustment process illustrates that there is at present no defined process of adjustment or defined standards of performance regarding the quick and satisfactory settlement of claims. However, the Superintendent has the authority under the current provisions of Part XVIII to judge upon the conduct of any adjuster in carrying out his business. His guidelines for such judgment are the published principles regarding the licencing of adjusters and the code of ethics as agreed to with the Ontario Insurance Adjusters Association (O.I.A.A.).

The O.I.A.A. represents "independent" adjusters, staff adjusters, self-insurers and representatives from the Accident Claims Fund. Its membership is about one-quarter of the estimated 5,000-6,000 "independent" and company adjusters in Ontario. Although it represents a majority of the "independent" adjusters, it is not sufficiently representative of all adjusters to permit reliance on its activities as the sole means of supervising the conduct of all participants in the claims adjustment process.

1. *First Report on Automobile Insurance*, page 135.

CHAPTER 6

The Insurance Act and the Activities of the Office of the Superintendent

A. INTRODUCTION

This chapter reviews the government presence in the general insurance industry, as defined in legislation and in practice through the activities of the Superintendent of Insurance.

A number of federal and provincial statutes pertain to the business of insurance. Included among provincial acts concerning insurance are The Insurance Act, the Marine Insurance Act, and a chapter of the Corporations Act respecting insurance corporations. The focus of this chapter is on the extent of the government presence as defined by The Insurance Act in the general insurance industry, excluding life and accident and sickness.

The Insurance Act establishes certain conditions for those persons or corporations who apply to conduct business in the field of general insurance.

The Insurance Act also requires the appointment of a Superintendent of Insurance and specifies certain general and specific duties to be carried out by the Superintendent in supervising the insurance industry. These are broadly defined in Part I of the Act as:

- Responsibilities corresponding to the licencing of insurance companies, agents, brokers and adjusters;
- Duty to ensure that the laws regarding insurance contracts and insurance practices are carried out; and
- Broad duty to engage in “general supervision of the business of insurance in Ontario”.

This chapter examines the conditions imposed on the general insurance industry and the activities of the Superintendent in his supervisory role over the industry, in regard to the following matters:

- Conditions of Licence for Insurers;
- Financial Condition of Insurers;
- Rates and the Cost of Insurance;
- The Insurance Contract and Policy and Application Forms;
- Marketing and Claims Adjusting Practices;
- Investigation of Problems.

In addition, the final section of this Chapter examines the participation of the Office of the Superintendent in providing, directly to the public, services related to insurance.

B. CONDITIONS OF LICENCE FOR INSURERS

1. Introduction

The Insurance Act provides that certain requirements must be met by an insurance company seeking a licence to carry on the business of insurance in Ontario. In addition, the Act empowers the Minister to impose any limitations or conditions relating to the carrying on of the insurer's business that he considers appropriate. It is therefore the duty of the Superintendent to determine the qualifications of and to licence all insurers carrying on business in the Province of Ontario.

The provisions in the Act with regard to licencing are further described in this section under the following three headings:

- general requirements and conditions of licencing;
- licence revocation;
- alternative actions.

2. General Requirements and Conditions of Licencing

The requirements for licence can be defined broadly as follows:

- The insurer must be of the type, in terms of organization and financial structure, as outlined in Section 23 of the Act.¹
- The insurer must comply with the capital requirements as set out in Section 28 of the Act.
- The insurer must provide certain information and documents preliminary to obtaining a licence, as indicated in Sections 30, 30a, 31 and 32a of the Act.
- The insurer must deposit, before receiving a licence, approved securities with the Minister in the amounts specified in Section 44 of the Act.

The Superintendent is required to determine whether applicants for a licence to carry on the business of insurance meet these and further conditions specified in the Act. In particular he must ascertain whether the company applying for a licence meets the capital requirements in the Act. In the case of a joint stock company, Section 28 of the Act requires the company to show that it has:

“paid up capital and surplus of not less than \$1,000,000, or such greater amount as the Minister in the circumstances may require, of which at least \$500,000 is paid up capital and at least \$250,000 is unimpaired surplus.”

In the case of a mutual insurance corporation, a cash-mutual insurance

1. Classes of insurer applicable to business in general lines of insurance include: joint stock companies, mutual corporations, cash-mutual corporations, other companies incorporated to undertake insurance contracts, reciprocal or inter-insurance exchanges and underwriters or syndicates of underwriters operating on the plan known as Lloyd's.

corporation, other companies incorporated to undertake insurance contracts, a reciprocal or inter-insurance exchange, or an underwriter or syndicate of underwriters operating on the plan known as Lloyd's, the capital requirements stated in Section 28 are:

- “the net surplus of assets over all liabilities exceeds the amount fixed by subsection 1 for the paid in capital stock of joint stock insurance companies”, and
- “net surplus of assets over all liabilities together with the contingent liability of members, if any, exceeds the amount fixed by subsection 1 for the paid up capital and surplus of joint stock insurance companies for the respective classes of insurance mentioned therein.”

These requirements do not apply to mutual insurance corporations insuring only risks other than mercantile or manufacturing on the premium note plan.

Further provisions of the Act set out various conditions to which the licensed insurer is subject in carrying on the business of insurance. Included among others are conditions related to:

- the definition and scope of the classes of insurance in which an insurer may carry on business, as specified in various sections of the Act;
- a duty to provide certain records and statistical returns as set out in Sections 78 and 79;
- any limitations imposed on the business of the insurer by the Minister, under the authority of Sections 24 and 33 of the Act;
- specific provisions for the carrying on of insurance business in certain forms; for example, Sections 27(2) and 127 to 144 apply to business carried out on the premium note plan; Section 28(3) applies to insurers who transact both fire and life insurance; Sections 326 to 341 refer to requirements for the carrying on of business by reciprocals.

The licence issued by the Superintendent authorizes the insurer, for the term of one year, to carry on the business of insurance so long as the actions of the insurer are not inconsistent with The Insurance Act. The licence must be renewed annually and proof must be provided to the Superintendent that the requirements outlined above continue to be met.

3. Licence Revocation

The Minister, upon recommendation of the Superintendent and after reasonable investigation, has the power under the Act to suspend, cancel or amend the licence. The Act sets out a number of conditions which provide or may provide cause for suspension or cancellation of a licence; these include:

- failure to pay an undisputed claim;
- failure to keep unimpaired the deposit required by Section 44;

- evidence of insufficient assets to justify continuance in business or to provide proper security to persons effecting insurance;
- failure to comply with any provision of law, or with the company's Act or instrument of incorporation or association;
- any contravention of the Insurance Act.

It is the responsibility of the Superintendent to examine the affairs of insurers and to report to the Minister whether any of the above problems exist. In certain circumstances the Superintendent must apply judgment as to whether an action by an insurer is in contravention of The Insurance Act. For example, as described again later, measures of the sufficiency of assets or determination of whether an industry practice is unfair or deceptive are subject respectively to "in-house" rules or to interpretation by the Superintendent and Minister.

If the Superintendent discovers possible contraventions of the Act, he attempts to rectify the problems through notice, meeting and discussion with company management. If this fails to result in a deficiency being made good or in the required improvement in operations, the Superintendent reports on the affairs of the insurer to the Minister. In certain circumstances the Act requires the Superintendent to conduct a hearing before any action is taken which interferes with the business of the insurer. In general, the Act requires that reasonable time be given to the insurer to be heard by the Minister in response to the report of the Superintendent.

As a last resort, the company's licence may be suspended by the Minister. The company does have a right of appeal to the Supreme Court. On suspension of a company's licence, for example because of a poor financial condition, the Superintendent has the power to seize assets and wind-up the company.

No insurer licences have been revoked in the last decade. This step is rarely undertaken for a variety of reasons. In the first place, the Superintendent is generally successful, through discussion or meeting, in resolving to his satisfaction problems or contraventions of the Act. Moreover, the process of suspending or cancelling a licence is cumbersome and lengthy and therefore not suited to resolution of minor transgressions. In addition, the adverse consequences of licence termination upon policyholders and upon the employees of an insurance company must be considered.

4. Alternative Actions

The Minister has the additional authority to impose penalties, as outlined in Section 94, which apply upon conviction of any contravention of the Act or its regulations or any failure to comply with the requirements of the Act.

Under authority of Section 33, the Minister also has the opportunity, at the time of annual licence renewal or at any other time, to:

“impose any conditions or limitations relating to the carrying on of the insurer’s business that he considers appropriate”.

The Superintendent may also become aware of the further problem of persistent consumer complaints. Such complaints may not be the result of direct contraventions of the Act, but may nevertheless be related to practices not in the public interest. In such cases, as described later, the Superintendent may have the power to make public reports dealing with complaint matters, while a further section of the Act permits the Superintendent to issue cease and desist orders in certain circumstances.

It is important to note that the Act imposes a constraint on the Superintendent in regard to making public certain information. Section 90 of the Act states:

“An information, document, record, statement or thing made or disclosed to the Superintendent concerning a person licensed or applying for the license under this Act is absolutely privileged and shall not be used as evidence in any action or proceeding in any court brought by or on behalf of such person.”

C. FINANCIAL CONDITION OF INSURERS

1. Solvency and Liquidity

The Insurance Act requires the Superintendent to examine, on an annual basis, the financial condition of every licenced insurer in Ontario to determine that the assets of these companies are sufficient to provide for the payment of their contracts of insurance and to justify their continuance in business. The Superintendent is required to report on this matter to the Minister.

To carry out his on-going responsibility in regard to monitoring the solvency of Ontario insurers, the Superintendent requires all companies licenced in the Province to file annually with his Office a financial statement of affairs in accordance with Section 79 of the Act. Those companies who are incorporated federally and all British and Foreign companies with branch operations in Canada must also report certain financial information to the Federal Department of Insurance. Much of the information required in the reports filed with either the Provincial or Federal Departments of Insurance is common to both jurisdictions; however, the reporting requirements differ in some respects.

Financial examiners in the Provincial Superintendent’s Office examine the financial affairs of each Ontario incorporated company. These companies are not required to report to the Federal Superintendent. In the case of federally incorporated companies and British and Foreign branches, the Ontario Superintendent relies, to a great extent, upon the financial review imposed by his federal counterpart. However, he expects to be kept informed of any delinquencies or deficiencies. At the same time, the provincial ex-

aminers conduct their own review of these companies, based on provincial reporting requirements, and will point out to the Federal Superintendent any deficiencies or irregularities that they discover.¹

If the Superintendent in his financial review finds that a company does not comply with any one or more of the provincial solvency rules or tests, a meeting is held with the management of the company to determine the reasons for the failure. Generally, a rehabilitation programme is worked out with management to rectify the problem. As a last resort, a report on the affairs of the company is made to the Minister and a company's licence may be suspended by the Minister. In the case of federally incorporated companies and branches, the Superintendent relies on the Federal Department to undertake rehabilitation procedures. If the Federal Superintendent fails to resolve the financial problems of the company, the Provincial Superintendent has the authority under the Act, in regard to *all* companies licenced in Ontario, to step in and require that changes be made.

In sum, The Insurance Act permits the Superintendent to exercise authority over the solvency condition of *all* companies licenced in Ontario. In practice, he concentrates his activity on Ontario incorporated companies. However, these companies, excluding farm mutuals, represented in 1977 only 9.7 percent of direct premiums written in property and casualty lines in this province and 17.2 percent in automobile lines. Therefore, the majority of business in general insurance lines written in Ontario is subject to solvency regulation at the federal level.

The financial review carried out at the federal level is based on solvency tests, some of which are specified in The Canadian and British Insurance Companies Act and in The Foreign Insurance Companies Act. The financial review at the provincial level is based on "in-house" rules developed over time by the Office of the Superintendent and applied to all general insurers to ensure their ability to pay all claims, as required by the Act. In some instances, compliance with certain solvency rules may be incorporated by the Minister as a condition in the licencing of certain companies to write business in Ontario. A description of the various tests applied was provided in Appendix I to the Committee's *Second Report on Automobile Insurance*.

In the First Report, the Committee expressed concern that the authority for key tests is based primarily on the force of long-established custom and practice built up over years in the Office of the Superintendent. Accordingly, in the second Report the Committee proposed further investigation into the matter of solvency and liquidity rules, as follows:

1. Provincially incorporated companies other than Ontario companies, who operate in the Province of Ontario, are few in number and in size and have minimal effect on the insurance business in this Province. For the most part the Ontario Superintendent relies on the financial examinations of these companies carried out by the Superintendent in the Province of incorporation.

- “Further consideration of the appropriateness of the solvency and liquidity rules as they pertain to the other-than-life insurance industry.
- Further consideration of the need to supplement or amend the present solvency and liquidity rules to make them more meaningful to present conditions.
- The advisability of legislating these rules or new requirements or providing for them in regulation.”¹

In summary, the adequacy of the existing solvency rules and the activities of the Provincial and the Federal Superintendent’s Office in solvency regulation have been demonstrated by the admirable record of financial stability experienced in Ontario and Canada generally. There may be, however, some concern that this record is accomplished at some cost to the consumer. The preservation of financial stability demands that cushions be built into the insurance system which may not result in a minimum cost of insurance to the consumer.

2. Investments

To further safeguard the financial stability of insurers, investment policy guidelines for insurers are set out in the Insurance Act. The Insurance Act defines explicitly in Sections 383 and 384 the types of investments in which an insurer may invest its funds. Sections 385 and 386 then outline a number of limitations regarding the exercise of the investment powers under the preceding sections. The Act does not comment on the use of income derived from investments.

One of the duties of the Superintendent is therefore to ensure that the investment policy guidelines in the Act are met and not exceeded by insurers in the Province. However, the Superintendent does not have the authority to establish a level of investments or to direct use of income from investments. The Committee, in studying the investment policies of automobile insurers, commented in its First Report that the industry as a whole follows very conservative investment policies, which in some cases do not even take advantage of the present investment limits allowed by legislation.²

3. Authority to Extend Inquiry Beyond the Financial Condition of Insurers

As previously noted in regard to solvency regulation, Section 79 of the Act requires every licenced insurer to prepare and deliver annually to the Superintendent a financial statement of affairs, exhibiting assets, liabilities, receipts and expenditures. This Section further provides that the insurer’s statement shall also exhibit particulars of business done in Ontario and any other such information as considered necessary by the Minister or

1. *Second Report on Automobile Insurance*, page 119.

2. *First Report on Automobile Insurance*, page 94.

Superintendent. This Section provides the Superintendent with the power to obtain further financial information than currently collected should the need arise in regard to determination of financial condition or any other matter pertaining to the performance of the industry.

Corresponding to the duty of insurers to file annual statements, the Superintendent is required by Section 17 of the Act to prepare and publish an Annual Report showing the particulars of the business of each insurer as determined by the financial statements filed by insurers or from any inspection or inquiries made into the business of the insurer.

In addition to the Annual Report, the Superintendent has the authority under Section 18 of the Act to publish other reports or any other matters considered by him to be in the public interest, subject to Section 90 regarding privileged information.¹ Combined with the power to request further financial and other information related to insurance contracts, this authority to publish allows the Superintendent to engage in new activities related to his duty to supervise the business of insurance.

D. RATES AND THE COST OF INSURANCE

1. Interest in the Matter of Insurance Rates

Various sections of The Insurance Act establish a government interest in the matter of insurance premiums and rates. The most explicit reference to the matter of the cost of insurance is outlined in Sections 365 to 367 of the Act, which are at the present time unproclaimed.

As mentioned in the Section Report,² Sections 365 to 367 of The Insurance Act would provide, if proclaimed, for the prohibition of unfair discrimination between risks and for the Superintendent to order adjustments in rates which he may find to be excessive, inadequate, unfairly discriminatory or otherwise unreasonable. These sections apply to all classes of insurance. In particular, Section 365 states:

“ . . . no insurer . . . shall charge a rate that discriminates unfairly between risks in Ontario of essentially the same physical hazards in the same territorial classification, or, if the rate is a fire insurance rate, that discriminates unfairly between risks in the application of like charges or credits or that discriminates unfairly between risks of essentially the same physical hazards in the same territorial classification and having substantially the same degree of protection against fire.”

Furthermore, Section 367 states in part that:

“It is the duty of the Superintendent, after due notice and a hearing before him, to order an adjustment of the rates for automobile insurance

1. *Supra*, page 81.

2. *Second Report on Automobile Insurance*, page 112 and pages 549 to 551.

whenever it is found by him that any such rates are excessive, inadequate, unfairly discriminatory or otherwise unreasonable.”

It is noteworthy that Section 367 permits rate adjustments only in the case of automobile insurance rates.

So long as these sections are unproclaimed, the Superintendent has only persuasive authority in requiring rate adjustments. Therefore, his analysis of cost and his monitoring activities over loss experience or price data have no “teeth” except for the threat that Sections 365 to 367 may be proclaimed if the industry acts against the public interest in its pricing practices.

While the Committee in its Second Report rejected rigid rate regulation as a long-term, or permanent approach to the surveillance of industry pricing practices, it nevertheless recommended the following measure in the short-term, pending formulation of more appropriate long-term methods of industry regulation:

“That consideration be given to the review and proclamation of Sections 365 and 367 of The Insurance Act and the granting to the Superintendent of more effective power for enforcing compliance with those sections if the need should appear necessary in the interim.”¹

2. Unfair Pricing Practices

Even without proclamation of Sections 365 to 367, the government interest in the cost of insurance is established by the prohibition in Section 388 of the Act against:

“any unfair discrimination in any rate or schedule of rates between risks in Ontario of essentially the same physical hazards in the same territorial classification,”

Where it appears that an insurer is engaged in an unfairly discriminatory pricing practice as defined above, the Superintendent, by authority of Section 391, may order the insurer to stop engaging in such practice. This stop order is subject to a hearing and may be revoked when the Superintendent is satisfied that the unfair practice is corrected and not likely to recur.

Section 388 also refers to any “person” engaged in the business of insurance and would appear to apply to such industry associations as established under an inter-company pooling or risk-sharing agreement. Accordingly, it would appear that the Superintendent has the responsibility and authority to examine the affairs of such associations to determine that they are not in contravention of Section 388 of the Act.

There is a further prohibition in Section 114 against discrimination in the cost of insurance on the basis of race or religion. There is no reference in

1. *Second Report on Automobile Insurance*, page 120.

the Act, other than in the unproclaimed sections, prohibiting inadequate, excessive or otherwise unreasonable rates, as legislated in many U.S. jurisdictions.

As part of his duty under the Act, the Superintendent must ensure that no company engages in pricing practices which are prohibited under the Act. In addition, Section 369 permits the Superintendent to investigate any question brought to his attention with regard to insurance rates. He does not have the authority to adjust rates as a result of his inquiry, but the Act specifies that the results should be reported in his Annual Report. In sum, the Superintendent has a basic responsibility to report on the reasonableness of rates and has certain authority to prohibit unfairly discriminatory pricing practices.

3. Filing of Rate Schedules

To carry out his investigative duty regarding rates, the Act provides the Superintendent with the authority to request, and requires insurers to submit upon request, rate schedules and any further information regarding rates (Section 362(2)) as well as information related to contracts of insurance (Sections 13 and 14(1)).

While the Superintendent has the authority under the Act to extend the information duty of insurers to a mandatory filing of rate manuals and rate changes, he does not at present exercise this authority. Rather, individual insurers and the Insurers' Advisory Organization file their automobile rate manuals with the Superintendent voluntarily, that is, on a "courtesy" basis. Rate manuals pertaining to property and casualty lines are filed on a much less consistent basis.

4. Statistical Returns

Section 78 of the Act further provides that statistical returns on the experience of the insurance business in fire, property damage and sprinkler leakage lines may also be required by the Superintendent according to any system of classification as he may impose. This authority is not extended to liability lines.

At the present time, mandatory statistical returns on loss experience are required by the Superintendent only for the automobile insurance class. The Superintendent presently designates the Insurance Bureau of Canada as his agent to perform this task. The Superintendent, however, has not to date called for a mandatory statistical plan in non-automobile lines so that the loss experience statistics collected by the I.B.C. in personal and commercial lines of property and casualty insurance are collected voluntarily and not on behalf of the Superintendent.

The purpose of the mandatory statistical plan in automobile lines is to

provide consistent loss experience data to the industry. It also permits the Superintendent to monitor rates and the ratemaking process, given that automobile insurance and in particular the liability coverage under the standard automobile insurance policy are essential to the driving public. In his Annual Report, the Superintendent publishes a table which illustrates the widely varying automobile insurance claims experience of the different classes of drivers for which statistics are collected.

A mandatory statistical plan provides a basis of uniformity in recording loss experience and a pooling of data so that rates can be set from the starting point of a consistent, reliable basis. Loss statistics are the primary, objective pieces of information used in the pricing process for insurance, to be combined with judgment regarding future trends in losses and operating costs.

The Superintendent at the present time reviews the total loss experience data of the automobile insurance industry together with information on the advisory rates compiled and filed voluntarily by the Insurer's Advisory Organization (I.A.O.) in its ratemaking capacity for member companies. The Superintendent may disagree with the actuarial assumptions or judgment on trending factors applied by I.A.O. in deriving its rates. However, as already noted, he does not at present have the legal authority under the Act to force I.A.O., its member companies or other individual companies to make rate changes, although he may be able to do so by moral suasion.

To a more limited extent, the Superintendent also monitors rates in property and casualty lines, where he must rely on the voluntary collection of loss experience data by the Insurance Bureau of Canada. However, there has been little emphasis placed by the Superintendent on extending mandatory requirements for collection of loss experience data into personal and commercial lines of general insurance.

3. Monitoring Price Competition in Automobile Rates

As part of his broad mandate to supervise the business of insurance, the Superintendent undertakes, to a limited extent at present, to monitor price competition. A survey is conducted each year to monitor price competition in respect of automobile insurance rates. The Department of Insurance does not at this time routinely monitor homeowner's insurance rates or rates in other property and casualty lines.

In the automobile insurance price survey, quotations are requested on premiums for all territories, for a mature driver and a 21 year old driver, for liability coverage only and for full coverage. Measures of the dispersion of prices are derived to detect clustering of rates, adherence to I.A.O. advisory rates, and lack of change year-to-year in the ranking of insurers according to price, all of which are interpreted as evidence of a lack of price competition.

6. Profitability and Operating Costs

There is no explicit reference in The Insurance Act, other than in the unproclaimed sections which prohibit excessive rates, to pricing practices that result in excess profits or to operating practices which reflect in a high cost of insurance to the consumer. Accordingly, the Superintendent does not at present have the specific authority to regulate profits or require that expenses not necessary for provision of the insurance product be eliminated from the cost of that product.

Nevertheless, corresponding to his broad duty of supervision over the industry, the Superintendent undertakes to examine the size, profitability and operating costs of all insurers licenced to write general insurance in this Province. He is assisted in this regard by The Insurance Act which imposes in Section 14 a duty on insurers to furnish information on request of the Superintendent.

Annual filing of the financial statements of all licenced companies engaged in both automobile and other lines of general insurance has been the traditional source of financial information on the industry. This data source has provided the Superintendent with some measure of profitability for individual companies, but not for the industry as a whole and not for individual product lines.

Despite the mass of information collected on individual companies as a result of the annual filing requirement, the usefulness of this information is somewhat limited, as it is related primarily to the requirements of solvency regulation. In its First Report the Committee commented that the Ontario Superintendent summarizes in his Annual Report only the names of companies licenced to write automobile insurance and limited information for individual companies concerning premiums written and claims incurred.¹ Similar information is reported for property and casualty lines. In the First Report, the Committee expressed surprise that more detailed data are not reported to the Superintendent concerning a business which has such importance and high visibility in this Province.²

In fact, an additional annual reporting requirement exists in the form of "S-9" Reports which are requested from all non-life insurers. This form collects information on the operating results by major product lines on a Canada-wide basis of insurers licenced to write general insurance in Ontario. This information is analyzed by the Office of the Superintendent to provide a summary of profit and loss of Canadian business by major classes of insurance and, in total, for all classes written by insurers licenced in Ontario.

The "S-9" form has several deficiencies. Reporting is not made man-

1. Statistical tables report the direct premiums written, direct losses and adjustment expenses incurred and the claim to premium ratio for the industry in total, by major class of insurance.
2. *First Report on Automobile Insurance*, page 207.

datory in that the Superintendent has not enforced this requirement on the few insurers who have not reported in the form required. Furthermore, this reporting system compiles data regarding operating costs and profitability *by product line*, but the data collected reflect the results for all business written in Canada by insurers licenced in Ontario and not solely the business written in this Province.

Therefore, in sum, the financial data reported to the Superintendent by individual companies fail to provide any detailed information, *for business transacted in Ontario*, on:

- overall profitability;
- profitability by various lines of insurance and by various geographic regions;
- elements of operating cost, including selling, claims adjusting and various administration costs; and
- differences in operating costs among various lines of insurance.

As a result the Superintendent is not able to monitor effectively the overall performance of the industry in the major classes of general insurance. For example, the Superintendent is unable to determine in adequate detail whether automobile insurance is subsidizing or is being subsidized by other lines of property and casualty insurance.

7. Classes of Insurance

Regulations to the Act define the classes of insurance which are referred to in the Act for the purpose of licencing insurers. The classes defined in the regulations are, for the most part, also used by the Superintendent as the basis for financial reporting requirements under the Act.

Fourteen classes of insurance were over time set out in the regulations, including life insurance and accident and sickness insurance as separate categories. The remaining twelve classes of insurance fall into the purview of the general insurance industry and include such broad classes as “liability insurance” and “property insurance”. The present, historically-defined list of insurance classes does not set out, as distinct categories, such classes as personal lines of insurance, commercial property lines or contract bonds; yet each of these classes may be deemed to be a separate market segment, with the possible need for separate reporting requirements and analysis of industry performance.

8. Summary

In summary, The Insurance Act establishes government interest in the pricing practices of the insurance industry but does not at present provide the Superintendent with authority to order rate adjustments. Should the Superintendent find rates to be unfairly discriminatory, the Act does provide him

with the authority to issue orders to stop the insurer from engaging in such pricing practices.

The Office of the Superintendent has initiated a number of programmes for the purpose of monitoring the ratemaking process to identify both unfairly discriminatory pricing practices and also, to some extent, other practices that result in excessively high rates. His powers in regard to correcting such practices are, with the exception noted above, limited to moral suasion.

The Committee notes and the Superintendent agrees that the Office of the Superintendent places less emphasis on industry supervision and supervision of pricing practices in property and casualty lines than in automobile insurance lines. As a result, less emphasis is placed on the collection of detailed statistical and operating information on property and casualty lines.

E. THE INSURANCE CONTRACT AND POLICY AND APPLICATION FORMS

1. General Provisions

Part III of The Insurance Act provides protection to the consumer by outlining a number of stipulations related to the insurance contract, including the terms, delivery and termination conditions of the contract. The duty of the Superintendent is simply to ensure that no insurer, agent or broker acts in contravention of these provisions.

Parts IV and VI deal specifically with the fire insurance and automobile insurance contracts respectively. Both Part IV and Part VI outline in varying detail the extent of coverage under the insurance contract and statutory conditions mainly related to recovery of loss under the contract, misrepresentation and termination procedures. In addition, a section of Part VI is specifically related to motor vehicle liability policies, while Schedule E to the Act outlines mandatory benefits in motor vehicle liability policies.

Section 122 of the Act outlines the statutory conditions which are part of every fire insurance contract in force in Ontario. The statutory conditions in the fire contract have not been revised for many years. They are similar or identical to many of the statutory conditions in the automobile insurance policy. There are, however, no statutory conditions defined in legislation for insurance contracts other than those pertaining to fire or automobile. On balance, the statutory conditions act more as a warning regarding what must be done by the insured to satisfy the contract than as a protection to the consumer. They are in any event superimposed on a contract of "good faith".

Also noteworthy among the provisions in Part IV related to fire insurance is Section 123 which requires that any limitation of liability under the contract with respect to:

- a deductible clause;
- a coinsurance clause; or
- any clause limiting recovery to a specified percentage of the value of the property;

be indicated on the contract by the printing or stamping of the following: “This policy contains a clause that may limit the amount payable”.

2. Policy and Application Forms

Part VI concerning automobile insurance is more detailed than Part IV referring to fire insurance in that it contains provisions pertaining to the forms of application, policy endorsement or renewal to be provided to the insured. Included in Part VI are provisions that:

- Permit the Superintendent to approve a form of owner’s policy which is to be considered to be a “standard” owner’s policy;
- Require approval of application, policy, endorsement and renewal forms by the Superintendent;
- Require a copy of the application to be embodied in or attached to the policy;
- Require delivery to each insured of the insurance policy, or where an insurer adopts the standard owner’s policy, a card evidencing insurance.

The Insurance Act does not require any similar approval of forms in regard to fire insurance, but general provisions regarding all insurers state that:

91(1) “The Superintendent may require an insurer to file with him a copy of any form of policy or of the form of application for any policy issued or used by the insurer.”

and require the Superintendent to report to the Minister:

91(2) “. . . any case where an insurer issues a policy or uses an application that, in the opinion of the Superintendent, is unfair, fraudulent or not in the public interest”,

In such cases, after a hearing, the Minister may prohibit the insurer from using such a form of policy or application. Therefore, the Superintendent has the authority to review and disapprove of policy or application forms in property and casualty lines, even though there is no requirement in the Act for automatic filing of these forms.

F. MARKETING AND CLAIMS PRACTICES

1. Licencing of Agents, Brokers and Adjusters

In responding to the marketing and claims adjusting practice of the insurance industry, which makes use of intermediaries who are not direct em-

ployees of a licenced insurer, The Insurance Act defines the broad functions of agents, brokers and adjusters. Part XIV of the Insurance Act outlines the requirements associated with the licencing of persons or corporations to carry on the business of an insurance agent, broker or adjuster. The Superintendent is required by the Act to pass upon the qualifications of and licence insurance agents, brokers and adjusters and to supervise such persons or corporations, with respect to rebating, handling trust funds, payment of commissions and other matters. Part XIV further sets out conditions for the revocation of a licence and requires the Superintendent to investigate and conduct a hearing prior to the suspension of a licence, or the refusal to licence or renew licence.

Part XIV is presently under review by the Superintendent and the Minister following concerns about the role of broker and adjuster, expressed by Mr. Douglas Carruthers (now Justice Carruthers) in his 1974 *Insurance Studies* and by the Select Committee in its *First Report on Automobile Insurance*. Current provisions in Part XIV and some of the proposals for change have already been discussed in part in Chapter 5 of this Report.

Licences are issued for a period of one year and are renewable by annual application. In its most recent submission before the Committee, the Association of Insurance Agents and Brokers of Ontario expressed concern regarding instances where an agent or broker neglects to submit renewal application forms for continuing his licence, but continues to operate as an agent or broker. There appears to be a failure on the part of insurers to check whether the licence of the agent or broker they deal with has been renewed and on the part of the Department of Insurance to take punitive action.

2. Disagreements Over Claims Under the Insurance Contract

The Superintendent does not have any authority under the Act to settle disputes and can only attempt to encourage an amicable settlement between the consumer and the insurer. However, Section 102 of the Act establishes a procedure for settlement of disagreements between the insured and the insurer. This Section provides that the insured and the insurer each appoint an appraiser and the two appraisers so appointed will appoint an 'umpire'. The responsibilities and duties of the 'umpire', although not so stated in the Act, are governed by provisions of The Arbitration Act in Ontario. The Insurance Act fails to provide explicitly the details for an arbitration process in respect of disagreements concerning the insurance contract.

3. Business Practices

Reference was made previously in this chapter and in Chapter 5 to the provisions in Part XVIII of the Act concerning unfair and deceptive acts and practices in the business of insurance. Part XVIII, incorporating Sections 388 and 389 of The Insurance Act, prohibits the insurance company, as well

as other persons engaged in the business of insurance from engaging in “any unfair or deceptive act or practice in the business of insurance”. This Part of the Act requires the Superintendent to ensure that laws regarding insurance practices are carried out and it gives him the authority to determine whether such acts or practices have occurred and to order the person implicated in such practices to cease engaging in the business of insurance.

Of the nine acts or practices defined in this section as unfair or deceptive, five refer to selling practices that might result in misrepresentation of a policy of insurance, in an inducement to insure or in charges to the insured in excess of the sales commission. The final clause defines as unfair any practice that results in unreasonable delay or resistance to the fair adjustment and settlement of claims. The acts or practices defined in the Act as unfair or deceptive are not all-inclusive so that the Superintendent is able to determine based on his own judgment what constitutes such behaviour.

In its First Report, the Committee made the following observations and recommendations dealing with this matter:

“The Committee is also concerned that the present Act puts the Superintendent in the position of being, in a sense, legislator, prosecutor and judge in certain circumstances. A specific example of this occurs in Part XVIII of the Act where the Superintendent, by the making of ‘in-house’ rules, is able to some extent to determine what constitutes unfair and deceptive acts and practices in the business of insurance. His Office is then authorized to investigate persons engaged in the business of insurance to determine whether they are involved in such a practice. The Superintendent is also empowered to hold hearings, to make decisions and to issue stop orders.”

“The Committee recommends that the Superintendent no longer be put in the position where he or his officials appear to be legislator, investigator, prosecutor and judge in relation to their supervisory and regulatory function.”¹

4. Marketing through Group Plans of Insurance

The Insurance Act, in Section 95(3) provides the Lieutenant Governor in Council with the legal authority to make regulations,

“(c) governing group insurance contracts or schemes, or any class thereof including prescribing and regulating their terms and conditions, qualifications for membership in groups and regulating the marketing of group insurance contracts and schemes;”

At the present time, no regulations have been adopted in regard to group plans although guidelines related to group marketing of automobile insur-

1. *First Report on Automobile Insurance*, page 208.

ance were issued by the Office of Superintendent in 1969. These guidelines are presented in Appendix H.

Further reference to group plans is made in the Act in regard to the rates charged for automobile insurance. Section 363 of the Act, referred to in the guidelines, prohibits the charging of preferential rates for a group of persons that result in a lower cost to an individual in such a group than such individual would have had to pay if insured individually. The provisions of Section 365 would also appear to apply to the situation of group rating. Section 365, which prohibits unfair discrimination in rates between risks of essentially the same physical hazards in the same territorial classification and unfair discrimination in the application of like charges or credits, however, is unproclaimed. As already noted, the provisions in Section 363 applies only to automobile insurance so that group pricing practices are presenting allowed in regard to group sales in other lines of general insurance.

The Superintendent in Ontario, along with other Provincial Superintendents, has called for filing of any group or mass merchandising scheme to permit monitoring of group sales to determine what regulations might be needed to govern this marketing approach.

G. INVESTIGATION OF PROBLEMS

In regard to both licencing and compliance with Part XVIII, the Superintendent has expressed concern about the length of time required to investigate problems, arrange and hold hearings and obtain a satisfactory resolution of the matters before him. There are no regulations with respect to the conduct of hearings or the appropriate time frame for their completion. Because of the length of investigations and the fact that the public may not be adequately protected should an insurer's operations be disrupted by a licence suspension or a stop order under authority of Part XVIII, the process of hearings may be inappropriate to resolve any problems which are not of a significant nature. Similarly, there is a reluctance on the part of the Superintendent to undertake proceedings to revoke the licence of an agent or broker for possibly deceptive or unfair acts because of the requirement for a lengthy process of investigations and hearings.

Because they are infrequently enforced, the stop order provisions under Part XVIII and the threat of licence suspension may not be real deterrants to certain industry practices, which fall short of being deceptive, but which may nevertheless be against the consumer's interest. However, there is no intermediate form of disciplinary action defined in the Act to be taken against agents, brokers and insurers who commit an 'offence' against the Act or the public interest—other than the threat of suspending or cancelling the licence. As a result, the Superintendent may be unable sometimes to deal effectively with minor transgressions that are not in the public interest.

The Superintendent may, with the authority of Section 18 of the Act, publish from time to time any notices, reports, decisions or other matters considered by him to be in the public interest, subject to Section 90 regarding privileged information. Publication of such information may bring problem areas to public attention and thereby result in improvement or resolution of the problem. An analysis of complaints is an example of information, which, if made public, might result in corrective action being taken.

An investigation unit is set up in the Office of the Superintendent to examine possible cases of non-compliance with The Insurance Act. The Annual Report of the Superintendent indicates that, in 1976, 96 investigations were initiated. The position of these and other investigations referred from the previous year was as follows:

Court Action	11
Administrative Hearing	8
Licence Termination	21
Cautions	5
Cease and Desist Orders	3
Unfounded	42
Still under Investigation	14

Of the 21 licence terminations, all involved the suspension of an agent's, broker's or adjuster's licence; some were temporary suspensions.

H. SERVICES TO THE PUBLIC

An important responsibility of the Superintendent, who is appointed to act in the public interest, is to provide services to the public such as investigation of complaints, answering enquiries and responding to requests for information. The Superintendent's Office receives numerous complaints from consumers in connection with their disputes with insurance companies. Complaints officers currently handle approximately 10,000 telephone queries each year concerning all forms of insurance, of which 2,000 develop to written complaints. About three-quarters of actual complaints regarding general insurance concern automobile insurance. An analysis by the Superintendent's Office of these complaints in the property and casualty sector of general insurance was provided earlier in Chapter 4.

In addition a pilot study has been conducted by the Office to classify complaints and produce a ranking of companies relating complaints to premium volume. The pilot study intends first to identify companies with a persistently high complaint level so they can be informed of their high ranking and can be requested to improve their operations. Secondly the study intends to highlight problem areas related to special risks such as dump trucks, taxis or high risk drivers or to inadequate capacity in certain territories. It is felt by the Office that, given evidence of the extent of certain problems through

a routine internal analysis of complaints, corrective action can be initiated to the benefit of the consumer.

While the Office of the Superintendent also responds to consumer enquiries and requests for information, its activities in educating and informing the public with respect to insurance matters are limited. For example, the Ministry of Consumer and Commercial Relations, of which the Office of the Superintendent of Insurance is a department, provides pamphlet material regarding various aspects of automobile and personal property insurance. The Committee has noted one specific effort of the Ministry to identify "Ontario Consumer Issues" in a household survey first conducted in April 1978. Among many other matters, consumers were asked about their buying habits for insurance and their experience with getting claims settled fairly. The Committee commented earlier in this Report on the nature and some of the results of this survey.¹ The Ministry intends to conduct a similar survey at a later date, with the first survey acting as a benchmark against which changes can be noted.

1. *Supra*, page 49.

PART III

OBSERVATIONS ON THE GENERAL INSURANCE SYSTEM

CHAPTER 7

The General Insurance Industry and Government Supervision

A. OBSERVATIONS ON THE GENERAL INSURANCE SYSTEM

Having completed its review of the property and casualty sector and the automobile sector of the general insurance industry, the Committee made a number of observations, many of which are considered in greater detail in the remainder of this Report. These observations, some of which are based on the background material in Part II, are summarized below in random order.

1. About Insurance

- Insurance is essential in many instances.
- There is a continuing need for finding ways to cope with a changing risk environment.
- Insurance is different from most other products in that it is intangible. Tangible benefits are received by only a small proportion of insureds.
- Insurance is priced differently from most other products, based on prediction rather than on actual production costs.
- Insurance is a pass-through system but it fails to work if costs are too high—that is, it is not worthwhile to insure if costs become very high.

2. About Consumer Expectations and Needs

- The consumer needs assistance in making his insurance purchase and in submitting his claim.
- The consumer wants a reliable product; he wants protection against insolvencies.
- The consumer expects insurance to be available.
- The consumer wants to pay the least cost for the coverage he needs. He expects the price he pays is fair relative to other risks of a similar nature.
- The consumer expects to be able to buy the coverage best suited to his needs. He expects to receive competent advice to assist him in his choice of coverage.
- The consumer may be willing to trade less service for a lower cost.
- The consumer wants ready access to someone who will answer his questions when they arise.

- The consumer expects to be treated in a competent and responsible manner by the people who sell him insurance and settle his claim.

3. About the Industry and Government Supervision

- The primary concern of the Superintendents of Insurance is with the solvency of insurance companies.
- The Federal and Ontario Superintendents share the responsibility for monitoring the solvency of companies doing business in Ontario, with the Ontario Superintendent relying, in most instances, on the financial review and tests applied by his Federal counterpart.
- The concern of the Superintendents primarily with solvency may inadvertently result in some cost to the consumer. The preservation of financial stability demands that cushions be built into the insurance system when may not result in a minimum cost of insurance to the consumer.
- The Superintendent in Ontario continues to rely principally on moral suasion to resolve problems in the industry, backed by the implied threat that unproclaimed sections of The Insurance Act, extending his authority, could be proclaimed if moral suasion fails.
- There are differing emphases put on the reporting and filing of various pieces of information with the Superintendent. For example, while automobile insurers routinely file information such as rate manuals and rate calculations, information on other lines of general insurance is not provided in a similar, consistent fashion.
- There are inconsistencies in the Superintendent's involvement in the gathering of loss statistics for various types of general insurance: reporting according to a uniform statistical plan is mandatory in automobile lines but not in property and casualty lines.
- Substantial financial information is collected by the Superintendents of Insurance but the reporting requirements of the Ontario and Federal Departments of Insurance differ in some respects. The reporting requirements and the compilation of industry data are not coordinated at the present time.
- While the financial reporting requirements of the Superintendents of Insurance are extensive, they fail to capture information concerning a number of aspects of the industry's operations, in particular:
 - overall profitability;
 - profitability by various lines of insurance and by various geographic regions;
 - elements of operating cost, including selling, claims adjusting and various administrative costs; and
 - differences in operating costs among various lines of insurance.

- The general insurance industry in this Province is relatively unconcentrated and the insurance buying public has a wide choice of insurance suppliers, except in the more specialized or difficult to rate lines of insurance.
- It is apparent that there are wide fluctuations in the annual profits earned by individual companies and the industry as a whole. The strength and commitment of the industry in this Province today demonstrates that on average profits have been adequate or at the least are expected to be so in the future.
- The industry's investment policies appear to lack innovation; in fact, many insurers have not even taken advantage of the present limits as laid down in legislation.
- There have been periods of time over the last two decades when the insurance buying public in various areas has had difficulty obtaining coverage or the type of coverage they want.
- In certain lines of insurance or for certain risks, the industry appears to experience difficulty in basing its rates strictly on objective criteria.
- In personal lines of coverage, the insurance industry has made little use of individual risk characteristics, such as general maintenance of premises and so on, in determining insurance rates but rather has relied on group characteristics.
- The general insurance industry has tended to rely on traditional ways of doing business. It is only recently that it has attempted to become more innovative in its efforts to respond to perceived consumer concerns.
- The industry has tended to continue using traditional operating and marketing methods. Progress in improving efficiency has only recently begun to be apparent.
- There is a general problem of communication throughout the industry. Many consumers do not understand the insurance process; this causes frustration and misunderstandings.
- The insurance product and the marketing system do not allow the consumer to price shop easily.
- The industry as a whole does not provide the consumer with ready access to a well-publicized enquiry and complaint handling service. Efforts in this regard are presently fragmented; they are sometimes undertaken at the initiative of individual companies.
- The industry supports many, varied efforts with regard to educational and training programmes for participants in the general insurance industry. Encouragement of participation in these programmes still appears

to be fragmented. There does not appear to be sufficient emphasis on continuing education.

- There are inconsistencies in the licencing by the government of many persons in the industry who are apparently doing much the same work.
- There is evidence of considerable concern with the various aspects of loss prevention. However, efforts at loss control are fragmented among government agencies, insurance companies, agents, brokers and individuals. There is little evidence of coordination commensurate with the apparent importance attached to loss prevention.

A number of the observations above reflect concerns regarding the way in which the insurance system operates. Others point out inconsistencies in the extent of the government presence in overseeing the industry. Further observations relate to consumer needs and the consumer's ability to understand the insurance process. Drawn together, these observations indicate the need for a rationalization of the government's presence in monitoring and fostering industry efforts to serve the public interest. They also indicate that the industry can do more to meet its obligations to the consumer through innovation and re-examination of its traditional functions.

B. GUIDELINES FOR THE GOVERNMENT PRESENCE

With the preceding observations in mind and its review of the industry complete,

- 7.1 The Committee concludes unanimously that there is a continuing need for a government presence in the general insurance industry. Government supervision of the insurance system is necessary to protect the public interest both because of the nature of the risk environment affecting the public and because of the essential yet intangible nature of the insurance product itself.

In consideration of the need for a continuing government presence in the general insurance industry, the Committee approached its detailed deliberations by establishing initially some general guidelines on which its specific conclusions and recommendations would be based. The Committee determined that:

- 7.2 Three key guidelines should define the nature of the government's presence:
 - a) The government presence in the insurance industry should devote explicit attention to the consumer's needs.
 - b) The government presence should not unduly burden the private insurance industry by over-regulation.
 - c) The private insurance industry must demonstrate its commitment to

providing protection against risks at a reasonable price to all citizens of the Province of Ontario.

More specifically, the Committee has reached the consensus, first, that both government and industry must direct their efforts more toward identifying and meeting consumer needs. This emphasis on a broader definition of consumer needs and services should be balanced with continuing emphasis on protection for the consumer through the testing of the financial solvency of insurers.

Secondly, the Committee has concluded that the private insurance industry should not be unduly burdened by government regulation. Since insurance serves a social purpose in coping with the risk environment, it presents to private enterprise a widespread market opportunity to fill the demand for protection against risks. The government, in ensuring that a social need is met, must be satisfied, however, that the private insurance industry is meeting the demand for protection adequately. If the government is not so satisfied, it can then decide whether it should:

- foster improvements in the industry-operated insurance system,
- regulate the actions of the industry in varying degrees short of discouraging its existence, or
- meet the need for protection through a publicly administered insurance mechanism.

In its Second Report, the Committee reached agreement that competition in the industry should be encouraged. After its review of the entire general insurance industry, the Committee continues to believe that the industry is capable of striving to meet consumer needs through competition.

The Committee therefore concludes that the role of the government presence should be primarily to *oversee* the way in which competition functions, in order to satisfy the consumer that lack of strict regulation is not resulting in industry practices contrary to the public interest. At the same time, as a general principle, the Committee concludes that the exercise of government supervision should not impose a burden on competition which is not necessary or appropriate to furthering the public interest and protecting policyholders.

Third, in giving consideration to the responsibilities of the private insurance industry, it is recognized by the Committee that the main role of the general insurance industry is providing the insurance product and in so doing its principal functions are:

- to provide a means of pooling risks—so that the premiums of the many will be available to pay the losses of the few, and
- to determine the premiums each insured must pay based on the degree of risk each imposes on the insurance system.

It is also recognized that, in theory, the general insurance industry cannot be expected to exceed its principal functions and assume social responsibilities that belong in the general public domain.

The Committee nevertheless believes that so long as the general insurance industry remains in the private sector, it must be prepared to conduct its affairs in a manner that as well gives due recognition to the responsibility of providing protection against insurable risks at a “reasonable price to *all* citizens” of the Province of Ontario wishing insurance coverage. With the commitment of the general insurance industry to this responsibility, the role of the government presence can be kept at a minimum—to oversee but not to interfere.

In summary, the guidelines set out in this section form the framework for the Committee’s more detailed consideration of the government presence and the corresponding responsibilities and functions of the Superintendent’s Office. These two topics were deferred by the Committee until completion of its study into the entire general insurance field and are therefore in part the subject of the following section of this Chapter. In regard to the topic of the Office of the Superintendent, the Committee wishes to establish, prior to outlining its observations in the next section on the form of government presence, the following additional guideline:

- 7.3 In identifying the need for a rationalization of the government’s presence in monitoring and fostering industry efforts to serve the public interest, it is not the intent of the Committee that the process of rationalization should entail any immediate restructuring of the Office of the Superintendent. Rather, the Committee’s recommendations in regard to the Office should be considered in the context of refining the *joint efforts* of the industry and the Superintendent’s Office with the intent that there would be no additional expenditure of public funds and no additional staff requirements.

C. OBSERVATIONS ON THE FORM OF GOVERNMENT PRESENCE

The Committee has concluded, in the context of the general insurance industry as a whole, that the role of the government presence in this industry should be primarily to *oversee* the way in which competition functions. In giving consideration to the most appropriate form of government presence, the persistent thrust in the Committee’s deliberations has been to attempt to provide a better balance between the two following activities:

- Those activities of the Office of the Superintendent which ensure that Ontario consumers are obtaining the “best value” for their insurance premium dollar.
- Those activities of the Office of the Superintendent which are intended to

ensure that consumers' insurance claims, when they are presented, will in fact be paid.

Essentially, the first set of activities are intended to ensure that insurance products are provided by the industry which are suitable and readily available to meet consumers' risk protection requirements and that these insurance products are offered at a price which bears a reasonable proportionality to cost. As the Committee has observed in its Second Report, the second set of activities, encompassing the surveillance of insurance company solvency, traditionally appears to have received greater attention than the first, from both the Ontario and Federal Superintendents of Insurance.

The Committee's observations on the form of government presence are outlined under the following headings:

1. Surveillance of the Effectiveness of Competition in Insurance Markets; and
2. Surveillance of Insurance Company Solvency.

The observations in this Report on competition and solvency are based upon the Committee's previous recommendations contained in its Second Report¹ and upon the further study of these matters which are described in Appendices I and J to this Report.

1. Surveillance of the Effectiveness of Competition in Insurance Markets

In order to ensure that Ontario consumers are obtaining the "best value" for their insurance premium dollar, the Committee in its Second Report considered three major methods of regulating automobile insurance rates, which are as follows:

1. A rigid rate regulation system under which a governmental authority fixes maximum rates, exact rates or a range of rates and these govern the charges that may be made for the various categories of risk.
2. A form of prior approval system wherein insurers must apply for approval of all rate changes before the rates can be put into effect.
3. Use of a body of regulations designed to monitor and perpetuate fully competitive marketing conditions which in themselves are expected to minimize premiums. This approach is termed "open competition rate regulation".

In its Second Report on the automobile insurance industry, the Committee concluded that:

"... open competition rate regulation is the form of automobile insur-

1. *Second Report on Automobile Insurance*, page 109 ff.

ance regulation which is best suited to the present market conditions in the Province of Ontario.”¹

This concept of regulation is based on the premise that the mechanisms of a competitive market place are likely to provide the best safeguards for delivery of the insurance product at a price which bears reasonable proportionality to cost and normal rates of return. It envisages a minimum level of market interference by regulators and then only in those situations where regulators believe that normal competitive mechanisms are absent or impaired. In theory, this concept envisages that regulators will monitor the effectiveness of competition by a series of economic tests of the market place.

In its further consideration and study outlined in Appendices I and J, the Committee has examined the appropriateness of reinforcing its observation regarding “open competition rate regulation” for automobile insurance and extending it to other forms of general insurance in Ontario in the broader sense of “monitoring the effectiveness of competition” in meeting the whole spectrum of public interest objectives. Needless to say, the Committee’s current investigations and study into the concept of “monitoring the effectiveness of competition” must be augmented to substantiate the utility of this regulatory mode and to identify the difficulties which may be contained therein. The direction of this form of government presence, however, is clear in its emphasis on consumer needs and cost efficiency. The Committee recognizes that studies in this direction in Ontario may be of interest to the other Provinces in the future, perhaps out of necessity because of the cost implications associated with other forms of rate regulation as the market and the industry continue to grow.

It is evident to the Committee that the rapidly growing and changing market place in Ontario, together with an ever increasing consumer awareness and expectation, requires a government presence in this Province which is highly sensitive to change and which can manage by exception, in that its limited resources can focus quickly on and provide solutions to market deficiencies. While this requirement may have been apparent in the past, it will become increasingly important in the future, as will the need to demonstrate publicly the effectiveness of the regulatory system, both to the Legislature, by means of annual reporting mechanisms, and to the public at large, through the fostering of efficient industry marketing practices, claims settlement procedures and a publicly perceived fairness in rate setting.

7.4 The Committee concludes that new directions toward satisfying the public that their interests are being met, must be formally recognized in insurance regulation in the Province of Ontario. In this regard, the Committee has considered a regulatory system which would monitor the effectiveness of competition in insurance markets and, in the Second Report, found this system to be the form of automobile insurance

1. *Ibid.*; page 119.

regulation best suited to the present market conditions in the Province in Ontario. As a method of regulation, it relies on the existence of a competitive market as the best means of ensuring an insurance system that serves the public interest. It requires that the market place be monitored on a formal, ongoing basis to ensure that it retains its competitive characteristics.

7.5 The Committee concludes that the monitoring of the effectiveness of competition is equally applicable and appropriate as a regulatory mode in other than automobile fields of general insurance.

The Committee has in broad terms looked at the details of a system of monitoring the effectiveness of competition that may be appropriate for Ontario. In so doing, the Committee has examined the concept of "open competition rate regulation" as developed in the United States. This concept is still in an evolutionary stage, but this evolutionary status only enhances the opportunity for new developments in Ontario. While much can be learned and applied from the United States' experience, Ontario's differing emphases and requirements may permit a greater degree of effectiveness in monitoring competition than can be achieved realistically in the United States. The smaller market place and the smaller number of competing companies augment this view.

In considering the design of a formal system suited to the environment in this Province, it is recognized that it might take several years to develop a reporting data base and the judgmental assessment capability with which the effectiveness of competition can begin to be monitored. In the interim, the Office of the Superintendent of Insurance could, pending further internal analysis of the detailed requirements, begin to require that data be reported which would satisfy the requirements of the monitoring tests developed in the United States by the National Association of Insurance Commissioners (N.A.I.C.). Specifically, data would be required corresponding to performance indicators, structural indicators and conduct tests as described below. Further reference to the nature of these indicators and tests and their applicability in Ontario is provided in Appendix J.

a) Performance Indicators

1. General insurance profitability, by line for all lines, country-wide.
2. Comparison of inter-industry rates of return.
3. Operating profit by line of general insurance for Ontario.

These three tests could likely be accommodated in Ontario with certain revisions to the present "S-9" Reports¹ and references to published statistics for the relative profitability of similar industries. Full compliance by those insurers presently writing in Ontario would be necessary

1. Supra, page 88.

and, in addition to their all Canada results presently reported, similar results would be required by major product line for their Ontario writings.

4. Variation in rates.
5. Independence in pricing.
6. Price changes per company per year.

The Superintendent's Office presently performs a survey of automobile insurance rates periodically throughout the year. A well conceived and more extensive periodic survey, together with the capability for computer analyses, could capture from the insurers the data which would satisfy the latter three tests.

b) Structural Indicators

1. Concentration ratios by line.
2. Market share ranking by line.

These data are presently readily available from analyses of the annual financial and statistical returns of insurers and from the Superintendent's Annual Report, at least on the basis of broadly defined product class groupings.

3. Entries and exits.

With concise definition of what this test should mean for Ontario in the present solvency regulatory environment, this information could be made readily available from annual licencing statistics.

c) Conduct Tests

Anti-competitive behaviour on the part of the industry or specific segments thereof should be highlighted by certain of the above tests. It could also be identified by the Superintendent's knowledge and awareness of the market place, much as happens at the present time. Specific minor difficulties relating to conduct would be dealt with as at present and major problems would likely be addressed in conjunction with the federal Combines Investigation Branch.

In reviewing the present activities of the Superintendent's Office, the Committee finds that many of the present practices in the Office generate much of the information required by the N.A.I.C. monitoring system and that certain of the necessary data are available through other statistical gathering agencies such as the Insurance Bureau of Canada. Therefore a proposal to satisfy the requirements of the monitoring tests developed by the N.A.I.C. would not necessitate a major change from the present activities of the Superintendent's Office, in keeping with the Committee's aim of not increasing costs. However, by contemplating a more formal and structured implementation of the present practices, the results of the data collection ef-

forts may be assessed more definitively and may be defensible to those who criticize the effectiveness of a form of government presence without rigid regulation.

- 7.6 The Committee recommends that the Superintendent develop and implement in Ontario a formal system of monitoring the effectiveness of competition to include both the automobile and the property and casualty sectors of the general insurance industry.
- 7.7 The Committee suggests that the monitoring system developed by the National Association of Insurance Commissioners in the United States provides a suitable starting point for development of a monitoring system suited to the market environment in the Province of Ontario.

Specifically, the Committee encourages the Superintendent to implement a formal data gathering and reporting system corresponding to the following tests and indicators:

1. Performance Indicators

- General insurance profitability, by line for all lines, country-wide.
- Comparison of inter-industry rates of return.
- Operating profit by line of general insurance for Ontario.
- Variation in rates.
- Independence in pricing.
- Price changes per company per year.

2. Structural Indicators:

- Concentration ratios by line.
- Market share ranking by line.
- Entries and exits.

3. Conduct Tests

In addition to commencing the process described above and using it to monitor the effectiveness of competition as development of the system affords, the Office of the Superintendent could also be developing appropriate public reporting procedures.

- 7.8 The Committee recommends that the Superintendent submit an annual report to the Legislature and public in Ontario, which is to include a review of the competitive indicators monitored by his Office and commentary on the analyses related to the statistical information.
- 7.9 The Committee recommends that amendments, where necessary or appropriate, be made to The Insurance Act to provide the Superintendent of Insurance with the authority to request such information and to publish such data and analyses as are needed for the system of monitoring the effectiveness of competition.

Specific attention as well could be devoted in the future to those new activities which might be undertaken or existing activities which might be utilized to better advantage to foster and promote competition in the insurance market place in Ontario.

7.10 The Committee suggests that the Superintendent and the Ministry of Consumer and Commercial Relations give consideration to the undertaking of initiatives which would foster or stimulate competition in the general insurance industry in this Province. The annual publication of the results of the Superintendent's monitoring activity would be a starting point.

The Committee has further considered the need for the Superintendent to exercise authority over situations identified as non-competitive, particularly when such situations lead to insurance rates that are "excessive, inadequate, unfairly discriminatory or otherwise unreasonable", as defined in the unproclaimed sections 365 to 367 of The Insurance Act.¹

7.11 The Committee recommends that Sections 365 and 367 of the Insurance Act be reviewed, updated and proclaimed. The Superintendent's authority over rate practices not in the public interest should be defined explicitly in legislation. It is not the intent of the Committee that proclamation of these sections would result in a system of rigid rate approval or regulation by the Superintendent. Rather the authority in these sections should be exercised primarily in situations identified as non-competitive by the competition monitoring system or in situations brought to the Superintendent's attention through complaints or other investigative activity.

2. Surveillance of Insurance Company Solvency

With its review of the general insurance industry complete, the Committee is now in a position to finalize its observations and conclusions concerning the solvency and liquidity rules applicable to general insurance companies licenced to carry on business in the Province of Ontario. In this regard, the Committee finds itself in a rather unique position. First, the solvency and liquidity of a company can only be reviewed in the context of its entire operations and only a relatively few general insurers confine their operations to this Province. Therefore, to a large extent federal authorities have assumed the monitoring and enforcement of solvency and liquidity rules. As a result, the Committee will be commenting on matters that transcend provincial boundaries and, in many instances, are an administrative concern of the Federal Superintendent of Insurance. Second, the Committee recognizes that it is difficult to argue with the success that the Superintendents of Insurance in Canada have had in ensuring the solvency of insurance

1. Refer to *The Second Report on Automobile Insurance*, Appendix F, page 549.

companies. The infrequency of insolvencies in Canada reflects an enviable record in this regard.

Nevertheless, the Committee would be remiss if it did not comment fully on the monitoring of the solvency and liquidity of general insurers, matters of such importance in the overall concept of insurance and in the provision of a reliable product to the consumer. The importance of comment on solvency regulation is reinforced by the consensus of the Committee that, first, the present rules are very conservative and, second, the universal application to all insurers may limit the development of the more efficient companies and mask the inefficiencies of others to the overall detriment of the insurance buying public of the Province.

The concern with the present solvency and liquidity rules centres on the fact that, as presently outlined by both the Ontario and Federal Superintendents of Insurance, they establish a rigidity and uniformity of measurement with which all insurers must comply. This inflexibility, with its base of safety and policyholder protection against even the most inefficient of operations, suggests that the rules must be viewed as conservative as they apply to most insurers and in total to the industry at large. In practice, both the Ontario and Federal Superintendents have assured the Committee and its staff that some subjective judgment is brought to bear in the enforcement of the rules in specific cases and that more leeway is given to some companies to bring their affairs into compliance with the rules, than might be the case with other insurers.

Comment on solvency matters is required also in relation to implementation of a system of monitoring the effectiveness of competition. One of the indicators of effective competition is the ease with which companies enter and exit from the market place. Because of the present solvency rules, it may be argued that involuntary exit as a result of competition is almost precluded. Viewed another way, it may be said that solvency regulation forces insurance premiums to a level which are at least sufficient to ensure that the solvency tests are met. Such regulation may therefore hinder competition at lower premium levels and might be termed anti-competitive.

A further concern of the Committee related to solvency is the matter of encouraging investment and hence capital growth in the general insurance industry. The solvency rules in their current uniform application place a limit or restriction on all insurers in their distribution of profits. In addition, other rules limit the forms of investment in the general insurance industry. It is the Committee's concern that uniform application of such rules restricts the opportunity to stimulate investment in insurance companies and, in particular, in the more efficient companies which have a better potential for profit.

7.12 In the Committee's opinion, a greater emphasis in the future on the monitoring and fostering of competition will achieve a better balance

between financial stability and the other public interest objectives inherent in the government's presence. As a further measure intended to improve this balance, the Committee recommends that further review be undertaken of the solvency monitoring process carried out by *both* the Federal and Provincial Superintendents.

- 7.13 In regard to the solvency rules applied both by the Federal Superintendent and by the Superintendent in Ontario, the Committee recommends that in general the rigidity of the current rules and their application be relaxed while still meeting the consumer's needs for a reliable product. In the Committee's opinion, the present rules appear to be unnecessarily conservative in the broadest context of protecting the *overall* interest of the public. Their universal application to all insurers on a uniform rigid basis may limit the development of the more efficient companies and mask the inefficiencies of others.

One of the concerns of the Committee in its prior studies, related obliquely to the question of solvency, has been the reporting and deposit requirements of foreign and branch office general insurers carrying on business in Canada. The Committee notes with interest several recent developments in this regard:

- Recent changes have been made in The Canadian and British Insurance Companies Act which now permit, but do not yet require, federally registered general insurance companies to report their financial position, results of operations and changes in financial position in accordance with generally accepted accounting principles. Reporting forms have been amended for both Canadian incorporated companies and foreign and branch offices so that they may report their financial information on consistent and similar bases in accordance with generally accepted accounting principles. It is anticipated that reporting on this more informational and useful basis may be compulsory for the 1979 accounting year.
- The Canadian and British Insurance Companies Act and The Foreign Insurance Companies Act have now been amended so that the same provisions concerning the ratios of "admitted assets" to "adjusted liabilities" are applicable to foreign and branch offices as to Canadian incorporated companies.

The Committee also notes that foreign and branch offices carrying on insurance business in Canada need only comply with one solvency test—that their admitted assets must exceed their adjusted liabilities by specific percentages as set out in the governing federal acts. Insurance companies *incorporated* in Canada are subjected additionally to legislated or "in-house" rules that define ratios for the total business that they may write, for certain reserve requirements they must maintain, for the dividends they may pay and the like.¹

1. For details on the rules currently applied by the Superintendent in Ontario, refer to the *Second Report on Automobile Insurance* Appendix 1, page 237.

In considering these present distinctions, the Committee believes that the prime, overall thrust of solvency and liquidity regulation for *all* insurers could be redirected to ensure foremost that there are sufficient “admitted assets” maintained by an insurer to meet its “adjusted liabilities”, as appropriately defined.

Furthermore, the solvency rules other than the asset-to-liability test could be relaxed, producing a multi-purpose effect, in part as follows:

- Some softening of regulator attitudes; with respect to the premium to equity rules where appropriate, could provide additional capacity and permit insurers to write more business, thereby stimulating more active price competition.
- Some relaxation of the dividend restriction rule could result in greater dividend payout which in turn could stimulate investment in insurance companies by those interested in a regularly paid return on their investment, thereby affording more equity for the industry required for structured and stable growth.
- Wider use of alternative forms of investment in the general insurance industry through debentures and preferred shares could also provide a basis for additional growth in the industry. Investments by the public by this means could be encouraged, so long as the solvency consideration regarding payment of claims would be maintained as the first legal obligation.

The result of relaxing the solvency rules, which is not without some risk, could, on the other hand, be very beneficial for Ontario and Canadian consumers at large.

- 7.14 The Committee suggests that the prime thrust of the solvency and liquidity requirements should be to ensure that there are sufficient “admitted assets” maintained by an insurer to meet its “adjusted liabilities” as appropriately defined. In regard to other measures of solvency and liquidity, the Committee recommends that they be made more flexible to individual company circumstances.
- 7.15 In order to assist the general insurance industry in attracting new capital, the Committee considers it appropriate for the Superintendent to re-examine the dividend restriction rule. Increased dividend opportunities could stimulate investment in insurance companies, thereby affording more equity required for structured and stable growth.
- 7.16 As further encouragement for increased investment in the insurance industry, the Committee recommends to the Superintendent that he re-examine the advantages and consequences of allowing wider use of alternative forms of investment in the industry such as debentures and preferred shares, so long as the first legal obligation of insurers is maintained to be the payment of claims.

7.17 To accomplish the objectives set out above, it does not appear appropriate to the Committee that the solvency measurements as a whole should be rigidly defined or set out in legislation. The Committee however encourages the Superintendent, after review of the solvency monitoring process, to give consideration to recommending the legislation of a prime rule or limited number of rules which are of a uniform or universally applicable nature.

In the light of the possible increased risk of insolvency associated with the relaxing of the solvency rules, it might be appropriate for the Superintendent of Insurance to consider implementing an "early warning system"¹ whereby each company would submit, at least annually and more frequently as required by the Superintendent, information concerning its operations. This information would permit the Superintendent to review objectively each company's operations and the trends indicated in its development and then bring to bear a more meaningful subjective judgment on any requirements that he may feel appropriate to restrict or improve an individual company's operations. During his comments before the Committee, the Superintendent made it clear that it would be relatively easy for him to continue to be aware of and monitor the operation of those companies requiring his more detailed attention.

7.18 To supplement the primary thrust of solvency regulation while ensuring flexibility in the system, the Committee sees merit in the implementation of a solvency monitoring system made up of a series of measures and indicators which would act as an "early warning system". Each company would be required to submit, at least annually and more frequently as required by the Superintendent, information concerning its operations. Data submitted by each insurer should be assessed not on the basis of specific ratios alone but, as well, in the context of the history, experience, management competence, book of business and so on of the individual company involved. This information would permit the Superintendent to review each company's operation and the trends indicated in its development in order to judge on a more objective, meaningful basis the appropriateness of the restrictions or guidelines to be imposed on an individual company to improve its operations.

As additional protection to the consumer, the Committee considered the need for a guarantee fund to be operated by the industry on either a pre-funded or post-funded basis. The Committee acknowledges that the experience of certain U.S. jurisdictions with these funds has not been without sig-

1. Reference to an "early warning system" as formalized by the National Association of Insurance Commissioners in the United States, was made in the *Second Report on Automobile Insurance*. See Background Study Three to the Second Report on "A Government Presence in Rate Regulation", page 543 ff.

nificant problems. However, the Committee recognizes that there could be certain advantages provided by this concept, such that:

- It would allow for freedom of entry and exit in that insolvencies could occur;
- The onus for protection would be on the industry; and
- The true cost of insolvencies could be identified and taken into consideration in the pricing of insurance products.

7.19 Given the Committee's conclusions regarding relaxation of the solvency requirements, the Committee considered the need for establishing a guarantee fund operated by the general insurance industry in this Province but agreed that its establishment did not appear to be needed at the present time. The Committee suggests, however, that the Office of the Superintendent continually re-examine this need in light of any changes in legislation, its own activities or industry performance in Ontario.

PART IV
CAPACITY

CHAPTER 8

Capacity: The Ability of the General Insurance Industry to Underwrite All Risks

A. INTRODUCTION

This Part and the following Parts V to IX address a number of basic concerns regarding the insurance system, both in general terms and with specific reference to property and casualty matters. The Committee has concluded over the course of its investigations that a number of broad issues, related to the general insurance system as a whole, attract a government interest.

The first of these issues, considered in this Part, is the ability or capacity of the industry in total and of companies individually to meet the demand in this Province for general lines of insurance. The matter of capacity is not an isolated issue, as considered in this Part, but is related in many ways to the other issues of availability, cost and coverage, communications, qualifications and conduct, loss prevention and the other matters considered in the subsequent Parts to this Report.

In this chapter, the Committee considers, first, the nature of the government's interest in the capacity of the private industry in this Province to fill the demand for protection against risks. Secondly, it addresses itself to the following determinants of adequate capacity and hence availability of insurance:

- The elements of a satisfactory operating environment which encourage industry growth;
- Efficient management of the industry to encourage consumers to make use of domestic capacity; and
- The use of mechanisms which maximize the utilization of the total capacity of the industry.

Conclusions and recommendations regarding these determinants of capacity are presented in each respective section.

B. CAPACITY AND THE GOVERNMENT INTEREST

1. Need for Capacity Provided by Insurers Licenced in Ontario Insurers Licenced in Ontario

The Committee sees both a compelling practical aspect to insurance, wherein the premiums of the many are used to pay the losses of the few, and an essential aspect, as there is a widespread individual need to avert the full impact of the devastating financial consequences of major losses. Both the

essential and practical aspects of insurance create an almost universal demand for insurance coverage as a means of protection against risks.

The insurance industry fills this demand by providing a mechanism for the pooling of risks within the parameters of a private business enterprise. The Committee maintains that the insurance industry must, as well, operate with the general public interest in mind. At the same time, there is a continuing need for the government to oversee the industry in carrying out its public interest responsibilities.

The initial interest of the government must be directed at the *capacity* of the insurance industry, that is, at its ability to satisfy the demand for insurance in this Province. Adequate capacity provided by private insurers in this Province is necessary and is also preferable, in the Committee's opinion, to a number of alternative approaches to protection against risks.

For example, it is preferable for the consumer to stay within the insurance system in this Province rather than seek insurance "offshore". Insurance through domestic carriers provides the consumer with the benefit of the activities and protection extended by the Office of the Superintendent; it ensures that the risk base in this Province is maintained as broad as possible for an effective pooling of risks; and it ensures the retention of premiums and investment in the Province.

It is furthermore preferable for the consumer to find coverage within the insurance system rather than be forced to self-insure. In many situations, the choice to self-insure is inappropriate and can endanger the financial position of both individuals and business organizations. As a further alternative to insurance within the private industry system, the consumer may look to a government-operated insurance mechanism or to government catastrophe programmes to assist in financial recovery after a major loss. As concluded in the Second Report regarding automobile insurance,¹ the Committee continues to believe that Ontario consumers can be served better under a system of general insurance operated within the private sector than by the adoption of a government-operated insurance system.

2. Capacity and Market Demand for Insurance

The capacity of the insurance industry in Ontario to meet consumers' needs for coverage becomes a matter of government interest, particularly in times when the market demand for insurance exceeds the industry's ability to provide the coverages demanded.

8.1 The Committee is generally satisfied that present market demand for general insurance coverage is being met by the industry in this Province. With the exception of market gaps in some commercial insurance areas or in certain territorial areas, the insurance-buying public has little

1. *Second Report on Automobile Insurance*, page 104.

or no difficulty in obtaining coverage from insurers in this Province. The Committee is pleased to see that problems of availability which existed in the past in some lines of insurance or in some areas of the Province have generally been resolved.

As for the future, it is a most difficult task to estimate demand in total or within specialized lines of general insurance and make assessments as to the likelihood of there being appropriate capacity to meet this demand in the future. However, it is apparent that a number of factors are contributing to increased market demand for coverage from the private insurance sector, among which are the following:

(a) Growth in Insurable Assets or Other Insurable Interests

The physical volume of insurable assets, represented by real capital spending, continues to grow in this Province although at somewhat more uncertain rates than in the past. Capital spending is a major factor contributing to growth in overall demand for insurance.

(b) Incidence of Loss

As indicated in Part I, the Committee is led to believe that the risk environment in Ontario today is much more stable than in many other jurisdictions in North America and elsewhere in the world. However, any future increases in the incidence of loss will add to demand for insurance. If the incidence of losses can be controlled, then a larger dollar value of assets can be insured with no overall increase in insurance risk and hence no greater demand on capacity.

(c) Changes in Judicial Awards and Legislated Definitions of Responsibility

Demand for certain coverages, in particular those related to personal injury or professional liability damages, is susceptible to increases in the level of judicial awards and to extension of liability through judicial decisions or changes in legislation to cover new situations and new hazards. Such changes have implications beyond the interest of the individual claiming damages; they extend to all insureds sharing in the insurance system.

(d) Inflation

In periods of rapid inflation, the replacement cost of insurable assets and the resultant dollar demand for insurance increase rapidly. Inflation brings further problems directly affecting capacity, such as inadequate pricing, particularly when significant time elapses between incidence of loss and settlement by an insurance company. An inflationary period is therefore of major concern both to the insurance industry and to the gov-

ernment which must oversee the industry's ability to cope with demand in this period.

It does not appear to the Committee that these market growth factors are being offset at the present time by any evident, extensive shifts to self-insurance. Self-insurance withdraws demand from the market which need not then be satisfied by insurance companies. Self-insurance may be a voluntary alternative to insurance and its choice may be based on an informed consideration of both the savings and risks involved. However, government concern must arise whenever self-insurance becomes a symptom of the industry's inability to handle demand.

Moreover, the Committee does not anticipate that government involvement in providing various forms of insurance coverage will in the near future be a factor in withdrawing demand from the private insurance market in this Province. This observation is necessarily dependent on the performance of the industry in meeting insurance needs. As well, it implies a greater obligation on the part of the private insurance industry to accept and service the future growth in insurance demand generated by expansion in physical assets, incidence of losses, inflation, and so on.

8.2 For the future, the Committee maintains that the government interest in the capability of the private insurance industry in this Province to handle the market demand for insurance coverage must extend beyond the financial capacity of insurance companies to underwrite risks. The government interest should be directed at a broader definition of capacity, one which encompasses other, equally important matters that determine *the ability to underwrite risks*. These further determinants of capacity include:

- A satisfactory operating environment which encourages industry growth;
- Efficient management in the industry as a means of encouraging consumers to make use of domestic capacity; and
- The use of mechanisms which maximize the utilization of the total capacity of the industry in Ontario.

These matters are the subject of the Committee's comment in the remainder of this chapter.

C. A SATISFACTORY INDUSTRY OPERATING ENVIRONMENT

Insurance industry growth to meet market demand for insurance coverage is determined to a large extent by a satisfactory operating environment. Accordingly, attention should be given to the impact of government regulation on opportunities for individual company expansion, the ease with which new companies are able to enter the Ontario market, the adequacy of return

on investment in the industry and the opportunities for alternative forms of investment.

The Committee has already indicated in this Third Report its conclusion that the government presence, although necessary to supervise the insurance system, should not unduly burden the private insurance industry by over-regulation. Following below, the Committee makes a number of further observations and recommendations regarding factors that would contribute to a satisfactory operating environment for the private insurance industry.

1. Solvency Regulation

In theory and in practice, regulation through solvency rules automatically places a restriction on the industry's capacity to write new risks and, in particular, may unduly limit the amount of business the more efficient companies may write.

8.3 To establish a satisfactory operating environment for industry growth, the Committee has already considered and recommended in Chapter 7 relaxation of the present solvency rules to permit companies capable of writing new business to expand their activity. The Committee has encouraged the Superintendent to examine the following options:

- (a) Greater flexibility in the application of the solvency rules as opposed to the rigidity and uniformity of measurements presently applied.
- (b) A shift in the thrust of solvency regulation to an asset to liability test, to be supplemented by periodic monitoring of other ratios on an "early warning" basis.

Relaxation of the solvency regulation process to suit the individual circumstances of insurers will provide a more suitable environment for capacity expansion.

2. Adequate Return on Investment in the Industry

In order for the general insurance industry to attract new capital, investors must perceive the rate of return in this industry to be adequate in comparison with alternative investments of similar risk. In the case of foreign companies licenced to write in Canada, increased investment in this country will only result if the profit opportunities here appear similar or greater than in their own domestic or other foreign markets.

An adequate return on capital can contribute to capital growth in two ways:

- (a) through retention of profits; and

- (b) through distribution of profits to investors to encourage further capital investment.

Capital growth in the Ontario property and casualty insurance industry, as represented by growth in average equity, was moderate over the 1973-1977 period, averaging 12.5% annually.¹ Improved profitability in 1976 and 1977 in most classes of property and casualty insurance and in automobile insurance made possible a relatively significant increase in average equity in these two years.

In addition, the financial overview in Chapter 3 of this Report shows that the five year, 1973-1977, estimated average return on equity for the property and casualty industry in Ontario is comparable to the return earned by other industries in Canada. However, the Ontario insurers' estimated annual return on equity fluctuated widely, while the annual return of the other industries remained relatively constant.²

- 8.4 The Committee recognizes the need for industry profitability as a condition for growth in the insurance industry. Furthermore, it believes that its recommendations in favour of the monitoring of competition as a regulatory mode for the general insurance industry, combined with relaxation of solvency regulation, will provide the appropriate environment for a reasonable and competitive level of profit.

D. EFFICIENT MANAGEMENT IN THE INDUSTRY

1. Industry Responsibility

- 8.5 The insurance industry, in carrying out its responsibility to provide protection at a reasonable price to all citizens in this Province, must demonstrate efficiency in its management. If the industry is not efficient in its operations, the consumer will feel that he is paying too much for his coverage as a contribution toward operating costs and will seek lower cost insurance elsewhere.

The Committee repeats its view that it is preferable that the consumer stay within the insurance system in this Province to benefit from the activities and protection provided by the Office of the Superintendent. Nevertheless, the consumer should not be denied the opportunity to seek out lower cost alternatives nor should he be penalized if he decides to look offshore for insurance coverage.

At the same time, it should not be the intention or the responsibility of the government to protect the industry in this Province. As better alternatives in the cost or service aspects of insurance may be available to the consumer elsewhere, it is the responsibility of the general insurance industry in this Province to look after its own interests by improving efficiency.

1. *Supra*, page 38.

2. *Ibid*.

Following below are the Committee's observations and recommendations regarding a number of factors that pertain to the efficient management of the industry.

2. Efficient Use of Investment Funds

Investment income earned by the general insurance industry in Ontario over the 1973 to 1977 period contributed in total \$669.3 million to insurance company revenues or an amount equivalent to 10.4% of net premiums earned in that five year period. The ratio of investment income to net premiums earned increased significantly over the 1973 to 1977 period in the liability and 'other lines' classes of general insurance, but showed little change in the property and automobile classes.¹

In the First Report, the Committee commented as follows in regard to the investment policies of general insurers:

"With respect to investment income, the investment policies followed by general insurance companies are conservative and ultra-cautious. These policies have been designed to stay well within investment requirements or guidelines laid down by provincial and federal regulatory authorities who are mainly interested in the solvency and liquidity of the companies . . .

The Committee views these minimal investment returns with concern, particularly in view of the fact that much of the money available for investment consists of premiums paid by the public in advance."²

The Committee regards investment income as an integral part of a company's income from its insurance operations. An effective investment policy is therefore necessary so as to reduce the total revenue an insurance company needs by way of premiums. The Committee's conclusions in this regard are as follows:

- 8.6 Efficiency in management of insurance operations must extend to investment of policyholder funds. The Committee continues to believe that the general insurance industry's investment policies are too conservative. The Committee expects the industry to make more efficient use of its investment funds as a means of reducing the premium burden on the insurance buyer in this Province.
- 8.7 The Committee also recommends that Section 383 of the Insurance Act be reviewed to examine the current appropriateness of the various investment instruments defined in this Section of the Act. The Committee is concerned in particular that the list of nations, specified in regard to investment in government bonds or other forms of government financing, is inappropriate and should be reviewed by the Minister.

1. Supra, Appendix D, Tables 1 to 5.

2. *First Report on Automobile Insurance*, page 127.

3. Efficient Operations

It is apparent, in terms of the \$2 billion direct premium volume in the Ontario general insurance industry as a whole, that significant savings to the consumer can result from a very small adjustment to the operating cost structure of the industry. Likewise, if operating costs can be reduced, then a larger dollar value of insurable risks can be assumed by the insurance industry with no overall increase in premium requirements and no need for expansion in financial capacity, that is, capital growth.

In examining the operating profile of the property and casualty insurance industry, the following comparisons to automobile lines were apparent over the 1973 to 1977 period:

- Acquisition costs in property and casualty lines average 7 to 9 percent higher than in automobile lines, owing primarily to the higher commission rates associated with property and casualty lines.
- Underwriting and policy processing costs in property and casualty lines average 5 percent higher than in automobile lines. There is a relatively large spread in processing costs between personal property and automobile lines, whereas the Committee had expected a closer cost relationship because of the large volume of similar policies underwritten and processed in both lines.
- The administrative costs in handling claims in property and casualty lines average about the same proportion of the premium dollar as in automobile lines. This cost comparison does not include adjusting costs allocated directly to the claims file, as this information is not reported by insurers separately from claims incurred.

The Committee believes that there is potential within the property and casualty insurance industry, as well as in the automobile insurance industry, for significant improvement in efficiency in the areas of:

- (a) marketing and acquisition,
- (b) underwriting and policy processing operations,
- (c) claims handling and adjusting, and
- (d) control over claims settlement.

8.8 The Committee is concerned that the industry has tended to rely on traditional operating and marketing methods and that progress in improving efficiency has only recently begun to be apparent. While the Committee believes that it is the responsibility of the industry to look after its own interests by improving efficiency, it suggests there is a potential for improvement that has been partially recognized with respect to automobile insurance, that must be extended further and should include all lines of general insurance.

In the automobile field the Committee is pleased to see a number of de-

velopments toward improved efficiency. For example, the Committee welcomes the expanding introduction of appraisal centres by both the Insurance Bureau of Canada and by individual companies and it expects that complete one-stop appraisal and claims settlement will also become a common service in the industry. Noteworthy as another example of industry efforts toward improved efficiency in the automobile insurance sector is the lower commission rate paid on automobile lines than in the property and casualty lines of insurance. The Committee encourages the general insurance industry to extend this attitude of efficiency wherever possible and to include as well the property and casualty sector of the industry. More specific comments in this regard follow.

(a) Acquisition Cost

- 8.9 As a step toward a more efficient and equitable insurance system, other forms of compensation should be considered by the industry as alternatives to the current commission rate structure applied by agency writers. The current commission structure, based on an across-the-board fixed percentage of the premium, is inequitable to policyholders in different rating classes, particularly to those who pay a higher pure premium. In most cases, the higher pure premium is unrelated to any increase in marketing or policy processing effort on the part of the sales intermediary, yet the policyholder is assessed a higher commission cost charge.
- 8.10 Both insurance companies and the agency system should undertake further and continual measures to improve efficiency in marketing and processing the insurance product to ensure that productivity keeps pace with market demand. The insurance industry is encouraged to examine new ways of marketing the insurance product. In addition, the insurance product, application and other forms should be reviewed with a view to their simplification and standardization to assist in streamlining marketing efforts and reducing processing costs.

(b) Underwriting and Policy Processing

- 8.11 It is the Committee's expectation that the somewhat higher costs of underwriting and processing personal lines policies relative to these same costs in automobile lines, can be reduced by simplifying the collection of underwriting information and streamlining the related administrative tasks, such as issuing of policies, policy amendments, communication, filing, and so on. The Committee generally encourages the general insurance industry to give more attention to improvements in policy processing systems and procedures and the greater application of data processing technology. Underwriting and policy processing are areas in which the industry, through the use of compu-

terization, should be able to make significant future strides in data capture and assault on expenses.

(c) Claims Handling, Adjusting and Settlement

- 8.12 The Committee's primary concern in the area of claims settlement is related to the direct costs of legal, independent and staff adjusting, appraisal services and related procedures which are charged directly to the claim file and accumulated as part of claims incurred. The Committee has been unable to obtain any meaningful statistics on these costs in property and casualty lines of insurance. Similarly, in its study into automobile insurance, only a rough estimate of claims expenses could be derived, based on periodic analyses by the industry.

In the automobile insurance field, it was estimated that 11¢ out of every \$1.00 of automobile premium earned by the industry was charged to the claims file while the total expense allocated to claims adjusting amounted to 15.1¢. The Committee expects that costs in property and casualty lines are higher and, therefore, considerable attention must be given to control over these costs.

- 8.13 The Committee recommends that insurers cooperate with the Superintendent's Office in providing better information on claims costs in all lines of general insurance. The Committee recommends that insurance companies be encouraged to disclose their costs of adjusting claims either through the Insurance Bureau of Canada's statistical or expense allocation reporting systems or through the Superintendent's Office.
- 8.14 The Committee further encourages the industry in its continuing efforts to reduce adjusting costs through such measures as telephone adjusting and more efficient internal claims processing procedures.

(d) Control Over Claims Settlements

- 8.15 Efficient management in the insurance industry must also extend to cost containment through control over claims settlements and through loss prevention services. The Committee has heard comments from several witnesses regarding over-generous settlements in personal property claims. The Committee urges the industry to undertake better measures for control of costs, particularly in regard to the smaller, more frequent claims.

4. Merchandising Through Group Plans

In addition to the above areas with potential for savings, the Committee has examined group merchandising as a marketing effort with significant potential to reduce insurance costs to the consumer. The Committee views the development of group merchandising as an area of initiative which has

been neglected by the general insurance industry despite its potential for more efficient delivery of the personal insurance product to the consumer.

The Committee recognizes that some concerns arise regarding the concept of group merchandising. First, concern can arise in the event that unqualified persons are used to endorse group plans or to solicit members of a group on behalf of an insurer or broker. In such cases, the apparent benefits or savings of group plans may encourage their purchase by a consumer without an adequate understanding of the product being bought.

Secondly, of concern is the fact that a group can be variously defined on the basis of an arbitrary form of organization or affinity. As a result, there is oftentimes difficulty in defining which groups might be eligible for a group plan agreement. The potential for reduction in insurance costs as a result of group affiliation is evident in regard to two distinct conditions: either the group loss experience justifies a lower premium rate or the group participates in a pre-established administrative medium that is adaptable to premium collection and policy distribution and hence creates savings in operating costs. Examples of the former are a group of non-smokers, a neighbourhood group that undertakes good maintenance of their properties or a group of retailers undertaking stringent loss prevention measures. Each of these groups provides a basis of affinity as a "safety group" with a potential for reduced premiums as a result of the loss reduction measures they undertake. However, these groups generally do not participate in a common, pre-established premium collection medium. This latter condition is considered by many to be necessary and the only appropriate condition for a group plan, if group merchandising is to avoid becoming a means of discriminating among policyholders.

The third concern is that group plans may in fact discriminate among policyholders and result in "creaming" of the more favourable risks. That is, only certain types of risks with favourable loss experience may be solicited or accepted into the group plan. Furthermore, "closed group" market segments could develop. A consumer not qualifying to join the group may represent an identical risk to those in the group, but may be excluded from the benefits of a lower premium through inability to join the group. In general, group plans may work to the detriment of other consumers who do not qualify for inclusion in the group plan. In some cases, these consumers may be required to bear a heavier share of the premium burden if group plans are allowed to "cream" the market successfully.

The Committee notes in Appendix H the guidelines put out by the Superintendent in regard to mass merchandising of automobile policies and proposals for guidelines set out by the Insurance Bureau of Canada to overcome some of the concerns inherent in group plans. Group merchandising must be carefully supervised to overcome the concerns associated with this approach to marketing.

- 8.16 The Committee encourages development in the general insurance industry of group merchandising initiatives, as forms of selling that reduce costs, so long as the group plans are carried out on sound bases that do not discriminate unfairly by “creaming” the market.
- 8.17 The Committee recommends that the Superintendent and the industry reconsider the necessity for differentiating between automobile and other general insurance group plans. At the present time, automobile group insurance plans only are subject to the limiting provisions of Section 363 of The Insurance Act¹ and to guidelines set out by the Superintendent in 1969.²

In general, it is recommended that consideration be given to the removal of restrictions on group merchandising plans as set out in the Act and in the guidelines, if study by the Office of the Superintendent can define a set of more relevant guidelines that protect the public interest but do not restrict non-traditional approaches to marketing insurance.

E. UTILIZATION OF TOTAL INDUSTRY CAPACITY

1. Industry Responsibility

- 8.18 The Committee earlier expressed its belief that, so long as the general insurance industry remains in the private sector, it must give due recognition to the responsibility of providing protection against insurable risks at a “reasonable price to *all* citizens” of the Province of Ontario wishing insurance coverage. This responsibility requires the industry to make efficient use of total industry capacity so that there are no gaps of availability.

In the Committee’s view, efficient use of total industry capacity requires that the following conditions be satisfied:

1. The insurance industry must devote ongoing attention to the development of skilled, informed and innovative underwriting practices.
2. The structure of the insurance industry must demonstrate the participation of a variety of companies in a variety of risk areas.
3. The insurance industry must show initiatives in making use of efficient intermediary practices which bring together insurance buyers and sellers.
4. Insurers must be prepared to pool risks with others in the industry.

Following below are the Committee’s observations and recommendations regarding particular areas for industry and government attention to satisfy these conditions.

1. Supra, page 94.
2. Refer to Appendix H.

2. Underwriting Risks

Insurance differs from other products because costs are not known at the time the product is sold. The capability of the industry to underwrite risks and remain solvent and profitable depends on its ability to predict losses. Without information on past loss experience, and without knowledgeable and skilled underwriters and actuaries, the insurance industry cannot properly evaluate future risk potentials, thereby endangering its ability to meet demand.

The industry can increase its capacity or ability to write risks by measures such as:

- Collective, uniform gathering of statistics on loss experience as a reliable base for loss prediction.
- Attention to the forecasting and analysis of economic trends that affect future loss prediction. The Insurance Bureau of Canada has recently undertaken to provide better services to its members in this area.
- Hiring and training qualified underwriters and actuarial staff at the individual company level.
- Co-operation of individual companies in organizations such as the Insurers' Advisory Organization, Association of Independent Insurers and Canadian Industrial Risks Insurers, which provide technical services in underwriting and risk inspection that, individually, some companies may be unable to support internally.
- Willingness of the industry to innovate in methods of risk evaluation and premium calculation. Use of experience rating and claims-related rating in addition to prospective rating could be utilized where applicable.

The underwriting function is most important in the ability of the insurance industry to accept all risks. The Committee regards this function as an area in which the industry in Ontario can expand its efforts in innovation and co-operation.

8.19 The capability of the industry to underwrite risks and remain solvent and profitable on its ability to predict losses. The following factors are of particular importance in regard to the underwriting function and will be commented upon in more detail in later parts of this Report.

- (a) The Committee draws specific attention to the need for collective, uniform gathering of statistics on loss experience to promote a reliable base for informed loss prediction and underwriting. All insurers should consider it to be their responsibility to contribute to and support industry-wide statistical plans in both personal and commercial lines of general insurance and to support improvements in these plans towards more meaningful and useful informa-

tion. The Committee expects that contribution of such data would not be tied to membership in the industry body which acts as the agent for collecting and analyzing this information.

- (b) Other collective efforts, in standardization of products or procedures to simplify underwriting, in risk inspection, research and in technical services, should also be supported widely by all insurance companies without the need for government regulations in this regard.
- (c) In regard to the skill of underwriters and actuarial staff in evaluating and pricing future risk potentials, the Committee emphasizes the need for the recruitment, hiring and training of qualified underwriters familiar with the local risk environment and the protection expectations of consumers. Wherever there is a lack of qualified underwriting or actuarial staff, the industry in Ontario should undertake to educate and train candidates for this function.

3. Participation of a Variety of Insurers in the Market Place

A variety of insurers writing in a variety of risk areas is needed in the Ontario market to ensure that gaps in availability are minimized and, as well, to ensure the availability of a choice of coverage from a number of competing insurers. The Committee sees the need for a balance of specialty writers, competing only in particular market segments, and numerous multi-line companies willing to accept a wide spectrum of risks. This balance is the sign of a competitive market. The Committee wishes to encourage a regulatory environment conducive to competition and the proliferation of various types of companies serving the consumer.

In certain circumstances or in certain market segments, it may be desirable for the government to relax taxation or provide other incentives for appropriate organizations to provide insurance which is otherwise unavailable. Such measures have, in fact, been adopted in regard to farm risks, where legislation and the activities of the Office of the Superintendent have fostered the development of farm mutual insurance companies. Similar encouragement in other market areas may be necessary from time to time, should persistent gaps of availability occur in certain market segments in the future. The Committee views such encouragement, in limited circumstances, as preferable to direct government involvement in the provision of insurance.

- 8.20 The Committee recommends that, if required in the future, the Superintendent advise the encouragement, through reduced taxation or other incentives, of cooperative groups or conventional insurers in supplying otherwise underserved markets, in particular circumstances wherein persistent gaps of availability are identified.

4. Farm Mutual Insurance Companies

The farm mutual insurance companies, described earlier in this Report and in more detail in Appendix E, originated over 100 years ago to write fire insurance and certain other coverages for farms in their local communities. Legislation limits farm mutuals to insuring those risks in their own community which are primarily of an agricultural nature. On the other hand, farm mutuals are exempt from the premium tax and from income tax because, in serving the needs of farmers in their local communities, they are looking after a market not served well by the insurance industry as a whole.

The Ontario Mutual Insurance Association (O.M.I.A.), on behalf of its members, requested the Committee to support the desire of farm mutuals to compete on an "equal footing" with all other general insurers in all areas of risk. The O.M.I.A. came before the Committee to point out that the conditions under which farm mutuals now operate in this Province have changed and that legislated restrictions on farm mutuals do not correctly reflect these changes. In particular, the O.M.I.A. pointed out that the sole business in rural communities is no longer farming, whereas the farm mutuals are restricted from insuring risks which are not primarily of an agricultural nature.

The Committee encourages the growth of any insurer or group of insurers willing to meet consumer needs in a particular market segment. The farm mutuals, in particular, have provided a stable market in farm communities at low cost with a high level of service. However, the farm mutual insurance companies operate under relaxed taxation privileges not available to conventional insurers. In considering the expansion of farm mutuals into other areas of insurance, the Committee's view is that this expansion must, in fact, take place on an "equal footing" with other insurers serving the wider market.

- 8.21 In order to encourage a proliferation of various types of companies serving the consumer, the Committee supports the Superintendent in his discussions towards relaxing the legislated restrictions imposed on the business of farm mutuals.
- 8.22 At the same time, the Committee recommends that the growth of farm mutuals into non-agricultural areas of business be treated as a separate book of business and be subject to the same taxes and other conditions imposed on insurers in the conventional market. In regard to the matter of taxes, it may be necessary for the Superintendent to request the federal government to re-examine its income tax rules to ensure that special privileges do not apply to farm mutuals or other insurers who have a substantial amount of business in other than farm risks.
- 8.23 In considering the relaxation of legislated restrictions on farm mutuals, there also appears to be an opportunity for the reinsurance market

to be opened up for the Farm Mutual Reinsurance Plan, to increase its ability to write both farm and any new business farm mutuals may be allowed to undertake. The Committee views this measure as desirable so long as any reinsurance assumed on non-farm risks is not subject to any advantage not provided to other reinsurers in this Province.

- 8.24 In considering the relaxation of legislated restrictions on farm mutuals, the Committee recommends that the Superintendent also give attention to reviewing the financial or solvency restrictions on farm mutuals. The Committee has recommended the review and relaxation of the solvency rules for all general insurers according to their particular circumstances. This same concept implies that the present rules for farm mutuals might continue to be applied, with some flexibility to permit the more efficient or financially stronger farm mutual companies to expand their business.

5. Reinsurance, Pooling of Risks Among Insurers and Efficient Intermediary Practices

So long as insurance is provided by private insurance companies, gaps in availability can result both because solvency restrictions limit individual insurer capacity and because insurers will select those risks which will build up a profitable portfolio.

While the industry as a whole may be capable of underwriting most risks, total industry capacity may be underutilized, because individual companies may wish to limit their risk exposures and hence may reject certain risks. This problem arises mainly in the case of individual risks with an abnormally high expectation of loss and risks with extraordinary large loss exposures, relative to other risks in the same class.

The available capacity of the industry as a whole may also be used inefficiently because poor marketing practices fail to bring together insurance buyers and sellers. This second problem arises when consumers, agents or brokers fail to reach the insurer or insurers willing to take on the risk in question.

To meet its responsibility of ensuring availability, the insurance industry must make use of mechanisms which maximize the utilization of the total capacity of the industry. A variety of practical mechanisms exist for facilitating the utilization of total industry capacity, including:

- Reinsurance
- Joint Underwriting, excluding Subscription Policies
- Residual Market Mechanisms for Automobile High Risks
- Subscription Policies and Layering, and
- Insurance Exchanges.

Descriptions of and comments on these mechanisms follow.

(a) *Reinsurance*

Reinsurance serves two important functions with respect to capacity and the availability of coverage. First, reinsurance shifts risks from an insurer, whose solvency might be jeopardized if it retained too large an amount of risk, to reinsurers who will share in the risk of loss. The reinsurer therefore takes over from the insurer part of the requirement for maintaining reserves and hence adds capacity for expansion.

Reinsurance also serves a further purpose in that it shelters primary insurers against major losses and therefore tends to stabilize the profits and losses of insurers, permits more orderly growth and protects capital for expansion.

The capacity of the industry in Ontario would be severely curtailed without access to reinsurance. An example of the impact of reinsurance on capacity occurred when the securities markets declined in the 1973-1975 period. Investment value declines seriously threatened individual primary insurer capacity in certain cases and many of these insurers reinsured entire lines with reinsurers for the period until markets regained strength. In essence, insurers borrowed equity from the reinsurers which thereby enabled them to maintain stability and growth in their own operations.

The Committee addressed the matter of reinsurance briefly in its consideration of the automobile insurance industry but deferred for further study the topic of "reinsurance and the part it plays in insurance costs".¹ During its continuing review, the Committee obtained no evidence that reinsurance increased the overall cost of insurance. In general terms, the profitability of the reinsurance industry is reflective of the profitability of the entire insurance industry. However, reinsurers normally consider a much longer period than one year on which to realize their return on investment because of their exposure to larger, more severe claims which may take a longer period of time to be settled.

The Committee has been frustrated, however, in its efforts to obtain precise information concerning the amounts of reinsurance placed offshore, since amounts placed through the international head offices of Canadian branches of British or foreign casualty companies are not reported and may be impossible to trace. Nevertheless it is understood that the flow of funds out of the country resulting from reinsurance would be quite small, perhaps limited to the profit on a transaction. Commissions, premium taxes, claims paid out, operating expenses and investment requirements would all represent funds which remain in Canada.

1. *Second Report on Automobile Insurance*, page 118.

(b) Joint Underwriting

Joint underwriting is undertaken by formal agreement among insurers who decide to share certain types of risks. These agreements illustrate *company or industry initiatives* to pool capacity. In some cases the pooling agreements also establish a pool of technical services and skilled underwriting staff.

Companies cooperating in joint underwriting, underwrite only a portion of a total risk. The portion may be:

- Pre-determined by prior agreement, as in the case of agreements between companies participating in Canadian Industrial Risks Insurers (C.I.R.I.).
- Linked to a company's share of total business written by an underwriting association or group, as in the case of the Factory Mutual system.

While subscription policies are a form of joint underwriting, wherein a portion of the risk is determined on a policy-by-policy basis, they are not arranged at the initiative of insurance companies and are therefore described separately below.

There may be a danger with formal underwriting arrangements for the pooling of risks in that they may develop into a 'separate market' which reduces competition in the underwriting of those risks which are 'sensitive to risk-sharing'.

(c) Residual Market Mechanisms

Residual market mechanisms are in essence supplementary insurance markets, usually applied to substandard risks, wherein all insurers operating in the voluntary market may be required to assume a share of the cost of the mechanism in proportion to their share of the voluntary business written in the Province. The residual market mechanism may be operated separately from other insurance companies or by servicing carriers. A residual market mechanism provides access to capacity for the market but in a manner which is peripheral to the operation of a voluntary insurance system.

A residual market mechanism is sometimes criticized because it can create two separate insurance markets at two separate prices for similar coverage. The residual market may grow to be a major market factor. To the extent insureds are treated differently if insured through the residual market, for example, by paying a higher cost for coverage, this would appear to be an unfavourable response towards resolving problems of availability.

There are no residual market mechanisms operative in this Province in

property and casualty lines although they are common in the United States. A residual market does exist in automobile lines and is served by the Facility which is now the third largest automobile insurer in Ontario.

(d) *Subscription Policies and Layering*

In the case of joint underwriting under *subscription policies*, it is the *task of the agent or broker to locate competing insurers* who are willing to take on a portion of a risk. The portion assumed varies usually according to the nature of the risk.

Subscription policies are reliant on the ability and success of the agent or broker in finding subscribers.

In some cases, there may be disagreement among the various subscribing insurers regarding settlement or problems of delayed settlement by one or more subscribers so that the insured does not immediately recover in full. These problems are however infrequent as the industry has long written on a subscription policy basis. Individual companies generally treat subscription policy claims in the same manner as ordinary policy claims.

A problem from the insurer's view point is caused by the agent or broker who enters an insurance company on a subscription policy without the binding authority to do so.

Subscription policy underwriting is not usually applied to large or complex risks, where special underwriting skills or risk inspection and loss prevention engineering skills are required. In such cases, the 'lead' company might incur the costs of these special services but receive only a portion of the premium. Other forms of joint underwriting wherein the costs of inspection and underwriting are shared appear to be more applicable to the large and complex risk situations.

Layering is a method of restricting an insurer's exposure by the acceptance of a single "layer" of coverage rather than a share of the total amount of the risk. In such cases, the insurer is responsible for payment only if a claim penetrates the layer which it has specifically underwritten. Major liability risks and large property risks are typically covered on a "layered" basis.

(e) *Insurance Exchange*

A 1970 U.S. study concluded that capacity "crunches" were not problems of availability but ones of reaching the insurer. To remedy this situation, it was recommended that an American insurance exchange be established which, like Lloyd's, would bring together in one place, insurance capital and the expertise of many underwriters.

Recent changes in New York State legislation have permitted the creation of a N.Y. Reinsurance Exchange which would act as a *centralized marketplace* for existing and possibly new underwriting capacity.

Most business in the N.Y. Exchange will initially be reinsurance related to insurable risks with minimum annual premiums in excess of \$100,000 and risks “of an unusual nature, a high loss hazard or difficult to place”.

The idea of an insurance exchange is possibly applicable in residential lines as well, where hard-to-insure residential risks could be directed to a central exchange or clearing-house where agents and insurers would work toward finding a placement.

The exchange concept simply attempts to bring insurers and customers together, particularly when there are difficult risk situations. It assists agents and brokers in their market search activities. It does not guarantee, however, that a placement of the risk will result.

The first three mechanisms—reinsurance, joint underwriting and residual market plans—are, for the most part, methods by which insurance companies, through agreements with other insurers, undertake to fill the gaps of availability which result from individual company underwriting constraints. The last two mechanisms—subscription underwriting and the insurance exchange concept—are methods that supplement the usual marketing practices by which insurance buyers and sellers are brought together. To a great extent the latter two depend on the initiative of an intermediary, either an agent, broker, or a central insurance exchange or clearing house. With the exception of the insurance exchange concept, the insurance industry in Ontario has made extensive use of these mechanisms for capacity utilization, with the result that few gaps of availability have been apparent in the past or are apparent at present.

Nevertheless, the Committee is concerned that willingness to take initiatives and to cooperate with others towards better capacity utilization is not uniform throughout the industry. Certain individual companies have demonstrated a greater willingness than others to take on risks, whereas it is the Committee's view that this responsibility rests on all insurers in this Province.

Furthermore, the Committee is concerned that insurers do not necessarily seek out the more efficient methods of utilizing industry capacity to ensure availability. For example, subscription placements may, in certain circumstances, be the most practical means of bringing together buyers and sellers of insurance, whereas in other circumstances the costs of market searching may be reduced by the willingness of individual insurers to accept all risks that come their way and then arrange for the automatic pooling of those risks which the individual companies are unable to keep on their own account.

In the event the industry does not meet its responsibility to utilize total industry capacity, or demonstrates that it is not endeavouring to seek out the more efficient approaches toward capacity utilization, consideration will need to be given to some form of government intervention, which may include:

- Mandatory pooling. All insurers may be required to share in a reinsurance or residual market pool for purposes of providing coverage to those risks not voluntarily accepted in whole or in part by individual companies.
- As a condition of licence, that all insurers write in all areas of the Province.
- As a condition of licence, that all insurers “take-all-comers”, that is, offer coverage to all risks and accept all risks willing to insure with them.
- Government provision of insurance, as an ultimate government response. The Committee’s study has shown this alternative to be a feasible response should it be warranted by industry performance and market conditions.

8.25 To meet its responsibilities regarding effective use of industry capacity, the Committee encourages the industry:

- (a) To seek out the most efficient mechanisms for utilization of capacity. These will likely differ in various market circumstances;
- (b) To seek new or innovative methods of bringing together buyers and sellers of insurance;
- (c) To demonstrate a reasonably representative industry presence throughout the Province; and
- (d) To avoid mechanisms which charge rates for risks rejected by the voluntary market on an entirely different rate structure from that in the voluntary market.

The industry, by following these guidelines, would be demonstrating its willingness to act in the best public interest.

8.26 In keeping with the above guidelines, the industry is encouraged to explore the concept of an insurance exchange that brings together insureds, or their brokers, with skilled underwriters and insurers. Such a concept has come to the Committee’s attention, in regard to the recently approved New York Insurance Exchange. Its primary application would appear to be in the area of hard-to-insure risks.

8.27 The Committee, foremost, expects to see a “take-all-comers” *attitude* on the part of all licenced insurers in this Province in respect of all coverages in which they do business. The “take-all-comers” principle requires each insurance company to accept all applicants, using its

own rate manual to quote premiums for each category of business it writes. This principle relies on the ability of each company to pool any business it does not wish to retain through an appropriate reinsurance mechanism. From the consumer's viewpoint, this approach provides the insured with direct access to the insurer of his choice. Furthermore, it is likely a more efficient marketing approach in many circumstances than one which relies on an intermediary to search the market for a placement.

PART V

AVAILABILITY, COVERAGE AND COST

The previous Part of this Report examined globally the ability of the general insurance industry to underwrite risks in this Province and to ensure that there are no gaps in availability. In this Part the topic of availability is examined in greater detail, first, in the specific context of personal lines of property and casualty insurance and, second, separately in the context of commercial lines.¹ The Committee makes a distinction in this Part between the individual and the commercial organization as a buyer of insurance in order to examine more carefully the differences in these two market segments regarding the need for coverage, the types of risks to be insured and the purchasing process.

Integrated within the broad topic of availability are considerations of coverage and cost. In saying that the consumer expects insurance to be available, it follows naturally that the consumer expects to be able to buy the coverage best suited to his needs and he wants to pay the least cost for this coverage. Hence, it is necessary to consider availability together with suitable coverage and reasonable cost. Therefore, this Part deals with all three matters, with somewhat greater emphasis placed on coverage and cost in the context of personal lines of insurance.

This Part is organized under the following headings:

- Chapter 9 — Availability in Personal Lines
- Chapter 10 — Coverage in Personal Lines
- Chapter 11 — Cost in Personal Lines
- Chapter 12 — Availability, Coverage and Cost in Commercial Lines

1. Personal lines of property and casualty insurance are defined as all property insurance related to residential or recreational properties and to all personal effects and articles; also included is personal liability coverage which is typically sold as part of the residential property insurance package. The commercial lines category consists in total of commercial property insurance, plus all classes of liability insurance other than personal, as well as virtually all "other lines" classes of insurance.

CHAPTER 9

Availability in Personal Lines

A. INTRODUCTION

Among the Committee's observations regarding consumer expectations is the following: the consumer expects insurance to be available; he does not expect to encounter difficulty in finding an insurer with whom to insure. The Committee maintains that it is the responsibility of the general insurance industry to meet this expectation, particularly in regard to personal lines of insurance. This chapter reviews the findings of the Committee with respect to the performance of the property and casualty insurance industry in meeting the consumer's expectations regarding availability in personal lines. First, the Committee comments on the necessity of residential insurance to the consumer. Residential insurance is defined to include all coverages normally included in a homeowner's or tenant's policy.¹ The Committee then looks at the availability situation in Ontario.

B. THE ALTERNATIVE OF SELF-INSURANCE

Residential insurance is demanded widely by individuals because it protects the individual's investment in an essential asset, that of housing. Housing is defined to include both the dwelling and basic contents; as such it is considered to be a social necessity as well as an essential personal asset. As a result, there can be said to be a social need to insure all dwellings, even the more hazardous, at reasonable cost.

The availability of coverage for residential risks is a matter of concern in that self-insurance is an unrealistic alternative for most individuals. It is the Committee's view that most individuals cannot afford to put their investment in their dwelling and contents at risk. Furthermore, many mortgage lenders continue to require that the residential property be insured to an adequate level to protect their interests.

Self-insurance may as well be an inappropriate choice if not based on an adequate level of information and knowledge regarding the balance between the savings to be achieved and the risks undertaken by not insuring. The Committee does not believe that the majority of individuals possess a proper understanding of the insurance process to make this choice wisely.

In some situations, self-insurance may be undertaken through membership in a formal self-insurance pool. However, under this approach, there is no supervision by the Superintendent to protect the interests of members of the pool with respect to solvency, proper operations, adequate funding and so on.

1. For further explanation, see Table 1 in Appendix F.

In addition, self-insurance does not guarantee protection to third parties in liability situations. In certain such situations insurance coverage may be considered to be socially necessary. The Committee has already recommended that automobile insurance providing third party liability coverage and also Accident Benefits coverage be made compulsory¹ and the government has adopted this principle for introduction by December 1, 1979.

The Committee further believes that, for the most part, self-insurance is undesirable at top levels of coverage which protect a residential property against catastrophic damages. The financial position of individuals and the community can be endangered if fire losses such as those experienced in the Town of Cobalt in May 1977 occur. However, self-insurance with respect to deductibles can serve a useful purpose in that it lowers the cost of insurance to the individual policyholder and it permits the insurance mechanism to deal with the more damaging losses.

In view of the need for insurance coverage on residential properties, the government has an interest in ensuring that the following conditions exist:

- There is sufficient total capacity in the insurance industry in this Province, as discussed in the previous Part, to underwrite all risks and, in particular, residential risks;
- Insurance is readily available from individual companies;
- The insured has access to an insurer willing to underwrite his risk;
- There is an availability of choice of coverages; and
- Insurance coverages are reasonably priced and affordable to most consumers.

These conditions are discussed in more detail throughout this Part.

C. AVAILABILITY IN ONTARIO

1. Risk Selection Process

A private insurer need not accept all risks. In fact, he may not be able to accept all the business directed to him because of his individual capacity constraints as defined by solvency regulations. In order to build a profitable portfolio within his capacity limits, the insurer may decide to reject certain risks in favour of accepting more "profitable" risks. Less desirable personal property risks, as sometimes defined by Ontario insurers, can include:

- a) Substandard risks such as any dwelling considered to be high risk on the basis of factors such as age, location or state of repairs; for example, homes that are:
 - of poor construction;
 - with poor electrical wiring;

1. *First Report on Automobile Insurance*, page 173.

- equipped with old wood-burning stoves;
- in a state of disrepair or poor maintenance;
- trailer or mobile homes, particularly of earlier poor construction;
- in remote locations, not readily accessible to water supply or fire fighting services;
- multi-occupancy dwellings with no special protection features;
- homes in areas indicative of high vandalism or theft exposure.

b) Abnormal exposures such as:

- history of previous losses;
- frequent travel or outside entertainment as indicative of high theft exposure;
- unfenced swimming pools;
- ownership of dangerous animals;
- “known questionable moral hazard” on the part of the owner or tenant;
- suspicion of arson.

c) Risks with high insurable values; for example, insurers argue that high-valued properties such as luxury homes have a higher theft exposure. Also any dwelling that is significantly underinsured relative to rebuilding cost.

As a result of this risk selection process, some consumers may encounter greater difficulty than others in obtaining coverage.

2. Problems of Availability

Sudbury and Northern Ontario

The most significant example of difficulty experienced in the placement of personal property risks occurred in Northern Ontario during the 1974 to early 1976 period, with Sudbury as the prime area of concern. This period is often described as the “market crunch”, when insurance markets tightened because of poor underwriting and investment performance in the general insurance industry.

A continuing concern in the Sudbury area prior to this time had been the inadequacy of fire protection, combined with high arson levels, poorly constructed dwellings and abnormal fire hazards in the business areas. When they found their reserves threatened by the “market crunch”, some, but not all, insurers were forced to reduce their writings in less profitable areas, which included Sudbury. Agents found that their company/agency agreements were discontinued as many companies withdrew from Sudbury and other Northern Ontario markets.

While there was a general reduction in the number of insurers writing in the Northern Ontario market, a number of other insurers assisted in filling

the void. Although insurance was made available in most cases when needed, the concern remained among both customers and agents that the choice of insurers serving the market had been reduced significantly.

The situation in Sudbury has improved considerably since 1976 and the market there is now considered to be competitive. Witnesses before the Committee from the Sudbury area have not encountered any recent problems of availability and there appears to be a drop-off in property insurance complaints from the "market crunch" period.

City of Toronto

A second example of concern regarding availability originated in the City of Toronto around 1965. Complaints about the lack of availability of insurance for downtown residential properties came at that time before the Fire, Housing and Legislation Committee of the City of Toronto. In 1965, this Committee had prepared model legislation to submit to the Legislature to set up a municipal assigned risk plan to handle uninsurable properties, which were largely in run-down areas requiring urban renewal. In place of this proposal, a committee of civic, Department of Insurance and insurance industry representatives was formed to handle complaints.

The industry-government committee, when first formed, established a set of guiding principles stating in part:

1. "rejection of an application or cancellation or refusal to renew a policy because of the physical condition of the property shall not occur without prior inspection of the premises."
2. "... If the property is not insurable because of physical hazards, the owner will be advised by the company, its agent or inspector of the specific improvements or repairs which are required to meet reasonable underwriting standards."

These guiding principles are still in force and are circulated periodically to remind those in the insurance industry of their obligations. The Committee is informed that they were last circulated in 1977.

The need for a mechanism outside the voluntary market to insure high risk properties in the urban core has not developed in either Toronto or other Ontario cities. Over the last decade, urban renewal and rehabilitation of older buildings have for the most part restricted the growth of high hazard "blighted" or "slum" areas in Ontario urban centres. As an example, the committee established to inspect hard to insure properties in the City of Toronto conducted 75 inspections over the November 1966 to March 1969 period, but a significantly fewer number from 1969 to 1979. The majority of these inspections showed that the main reasons why owners could not obtain insurance were twofold:

- The houses were such that the value of the property as a whole would be of no less value if the house were removed from it.
- The houses were in a state of disrepair indicating virtually a complete lack of attention by the owners.

In some cases, the owners were not themselves seeking insurance, but rather mortgagees were demanding unrealistic amounts of insurance on these properties. While some problems of this type continue to be encountered, no large-scale deterioration of the urban core has occurred in Ontario to compare with the experience in the United States where large areas of a city core are “red-lined” by insurance companies as uninsurable at reasonable cost and therefore are not accepted on the voluntary market.

3. The Present Situation

There have been periods of time over the last two decades when the insurance buying public in various areas of the Province has had difficulty obtaining personal lines of coverage. The Committee is informed of continuing problems of placement in other parts of Canada, such as Montreal, St. John’s and Vancouver and in the United States, particularly, where supplementary methods of handling substandard risks have been devised, such as the “fair access to insurance requirements” (F.A.I.R.) plans in many states.

Moreover, in the automobile insurance market, the Committee has found that a substantial “residual” market exists in Ontario of motor vehicle owners unable to obtain coverage in the voluntary market. This “residual” market is at present insured under the Facility,¹ which is a mechanism for pooling risks described in both the First and Second Reports on automobile insurance. In the near future it is understood that the residual market in Ontario is to be handled by the Facility Association,² which is an alternative mechanism proposed for pooling high or substandard risks.

In contrast there does not appear to be a problem in Ontario today of a residual market in residential lines of insurance and hence no pooling mechanism is in operation to insure personal property risks which may be rejected by the voluntary market. It appears that the voluntary market at the present time absorbs virtually all personal lines risks.

The Committee sees a number of factors which likely affect the availability situation in this Province. In the first place, there is the willingness of individual insurers to accept most risks and to accept the obligation to inspect poor risks. Most insurers conducting an inspection will agree to take on a residential risk if recommendations for improvement made by their in-

1. *Second Report on Automobile Insurance*, pages 28 and 231.

2. *Ibid.*, page 28.

spectors are carried out. To some extent this willingness is the result of a lesser incidence of claims in residential lines compared to automobile lines. Secondly, the activities of agents and brokers in arranging subscription placements, channelling high-hazard or high-exposure properties to specialty brokers and working with municipal agencies, such as the City of Toronto property inspection committee, all assist the hard-to-insure risk in obtaining coverage. The association of Independent Insurance Agents and Brokers of Ontario also assists agents through its Marketing Aid Programme in locating a carrier for their clients.

There appears as well to be a lesser degree of urban and social problems in this Province than encountered in many cities and regions in the United States. For example, there are fewer properties of significant high hazard or questionable value so that residential properties for the most part can be insured by the insurance industry at reasonable rates which are still commensurate with the risk involved. There is no apparent "red-lining" by insurers in this Province, wherein companies designate defined areas as unfavourable markets and refuse to sell insurance in these areas. For the most part, all areas of the Province appear to be reasonably competitive, although in some areas to an unequal degree.

Also contributing to the availability situation are the activities of the Office of the Superintendent. The Superintendent's Office endeavours to assist consumers who have had difficulty in obtaining coverage and has been able in most instances to obtain the cooperation of insurers in arranging a placement.

4. Future Solutions

The Committee must take into account the possibility that the present situation, with few problems of availability, may only be temporary, as a reflection of the relatively high profitability and competition in the industry at the present time. Should market conditions become less favourable, problems of availability may recur in the future. Therefore, the Committee emphasizes that the industry must realize its responsibilities to make insurance available to all at reasonable cost and that it give thought to means of resolving availability problems before they arise as significant concerns.

Should the industry fail to provide availability, the Committee has considered a number of consequent government measures to ensure availability in personal lines. One potential measure is the establishment of a government sponsored or subsidized residual market mechanism as represented by the F.A.I.R. plans in the United States.

A F.A.I.R. plan is a mandatory pool of insurers formed to write basic property insurance when coverage is not available in the normal voluntary market. Insurers participate in the premiums, losses and expenses of the pool, while federal funds are available in the event of catastrophic situa-

tions. F.A.I.R. plans have been criticized because they create two separate markets, often at two separate prices, although recent federal legislation proposals would eliminate surcharging. They have also been criticized for their inability to solve the underlying problems of unequal treatment for "red-lined" markets such as ghetto areas.

Further government measures could require through legislation that all licenced insurers "take-all-comers" and cooperate in a risk-sharing mechanism to support this approach or that all licenced insurers be required to sell in all parts of the Province. The Committee's conclusions and expectations follow.

9.1 Among the general insurance industry's primary responsibilities is the function of providing insurance for personal residential and liability risks to all residents of Ontario. The Committee maintains that, for every residential risk in Ontario, the insurance industry should be able to establish a reasonable rate commensurate with the risk involved and hence offer coverage on all risks.

The Committee once again emphasizes with specific reference to personal lines that the insurance industry should endeavour to meet its responsibility to provide coverage, first and for the most part, through a "take-all-comers" attitude on the part of individual insurers.

The Committee finds this approach to be the most efficient method of bringing together the buyers and sellers of personal lines of insurance and it provides the consumer with direct access to the insurer of his choice. The industry should at the same time look at collective efforts at pooling substandard risks which individual insurers do not wish to keep on their own account.

9.2 The Committee encourages the industry to cooperate in innovative, contingency plans for ensuring availability. An example has come to the Committee's attention concerning a pilot programme initiated in the State of Connecticut.

The Connecticut pilot programme is a voluntary, cooperative effort of insurance companies, agents and the Department of Insurance to make insurance more readily available to homeowners through a toll-free, state-wide inquiry and placement service. Participating agents and companies make every effort to fulfil consumer's needs and no property is declined coverage except for good cause and valid reasons. Any company rejection of coverage is subject to a review by a management committee and the Department of Insurance. The Committee sees merit in such a programme even in times when there are no widespread problems with availability.

9.3 Should the industry fail to provide availability, the Committee has considered the need for government measures to ensure availability in per-

sonal lines, including the establishment of a government-sponsored residual market mechanism and legislation to require insurers to "take-all-comers" or to sell in all parts of the Province. The Committee views direct government measures as a last resort and not necessary in the current market situation.

Nevertheless, the Committee emphasizes that the industry must recognize its responsibility as a whole to accept all personal coverage risks and that all individual companies must share in this responsibility. While the Committee does not wish to recommend that it be mandatory that all insurers market in all areas of the Province, it expects that the industry will recognize the need not only for availability, but for a choice of coverages available from a number of competing insurers.

CHAPTER 10

Coverage in Personal Lines

A. CONSUMER EXPECTATIONS REGARDING COVERAGE

In this chapter the Committee examines what it believes to be the expectations of the consumer regarding coverage in personal lines of insurance. These expectations, as perceived by the Committee, can be generalized as follows:

1. The consumer expects that he will be able to obtain the coverage which he feels is best suited to his needs;
2. The consumer wants to be able to comparison shop; and
3. The consumer may be willing to trade less coverage for a lower cost.

This chapter outlines the Committee's observations regarding the implications for the insurance industry of these consumer expectations.

The primary question addressed by the Committee in this chapter is whether the property and casualty insurance industry, left to its own efforts, will satisfy consumers' expectations regarding coverage, by making available a product that meets those expectations. In this regard the Committee has had the opportunity to learn about the various policy forms available for homeowners and tenants through its consultant's overview presentation on personal lines of coverage; through the cooperative efforts of the Office of the Superintendent, the Insurers' Advisory Organization, and representatives of a number of insurance companies and adjuster and appraisal firms, and through the presentations of several individual insurers who, in many cases, were able to provide information on their own, unique policy forms.

Although there is no uniform, standard policy in personal lines, the Committee found a basic similarity of approach in designing homeowner's policies and the preference for marketing a homeowner's package rather than individual coverages. As indicated in Appendix F, most companies market a number of homeowner's forms for a variety of reasons including marketing advantages, consumer needs and underwriting reasons. Comments on the major component parts of a homeowner's package policy follow below.

1. Coverage on the Dwelling

The Committee believes that the consumer expects to receive "full recovery" on damage to the dwelling in the event of a loss. "Full recovery", in the Committee's view, implies no coinsurance on a catastrophic loss, recovery on a replacement cost value basis and recovery not limited by the es-

timate of the insured value of the home. Further conditions for "full recovery" could provide that recovery include debris removal, recovery not limited by the restriction that the home be rebuilt on the same site and likely other similar conditions.

Policies marketed by the industry at the present time may by their terms limit "full recovery" in certain circumstances. A homeowner's dwelling policy provides coverage on the basis of replacement cost, determined as the amount it would cost to repair or replace property with material of like quality and like kind within a reasonable time after a loss. However, the optional loss settlement clause in the typical policy places a limit on the amount that the insurer will pay at the least of:

- the amount of actual expenditures for repair or replacement;
- the amount of insurance coverage carried; or
- a proportion of replacement costs, if insurance coverage is below 80 percent of the replacement cost of the entire building.

The conditions of the optional loss settlement clause can result in the insured bearing a portion of the costs of replacement for either full or partial damages, if the amount of insurance coverage carried falls below the amount of damage incurred or below 80 percent of the rebuilding cost of the home at the time insured. By not maintaining insurance equal to 80 percent of the value of his property, the insured in effect coinsures, that is, he bears part of the cost of the loss. The insurance company makes payment on the following basis:

$$\frac{\text{Amount of insurance carried}}{\text{Amount of insurance required}} \times \text{Loss} = \text{Amount Paid by Insurer}$$

The burden of maintaining the proper amount of insurance coverage falls on the insured. However, since the start of the inflationary period in 1973-1974, insurers have been encouraging policyholders to obtain adequate amounts of insurance on their dwellings by bringing insurance into line with the actual cost to rebuild and by increasing the amount of insurance coverage each year to reflect the increasing costs of rebuilding. For this reason, "inflation protection" endorsements are added to policies by many insurers. These endorsements and other methods designed to encourage "insurance to value" increase the amounts insured automatically on a periodic basis or at the time of renewal. The value of the property and the insured amount is increased either on a fixed percent basis or according to the change in the Consumer Price Index, the Residential Construction Price Index or other inflation indicators. The premium paid by the policyholder increases in line with the adjustment in insured value.

The insured who undertakes to "insure to value" will generally recover the full amount of his loss, on a replacement cost basis. In addition, the Committee is informed that many insurers waive the optional loss settle-

ment clause including the limit to recovery set by the amount of insurance carried, in cases of major loss or where the amount of underinsurance falls only slightly below 80 percent. This policy is typically followed when the sum insured has been calculated on the basis of an evaluation procedure approved by the insurer. The Committee is nevertheless concerned that full replacement cost value cannot be precisely defined and yet it can be applied by the insurer to determine coinsurance and is used as a limit to total recovery.

Accordingly, the Committee believes that the Consumer's expectations for full recovery would be better met by a homeowner's policy that provides *full replacement cost coverage* on damage to the dwelling. With full replacement cost coverage, the estimated value of the dwelling would be used only for premium setting purposes. For recovery purposes, there would be no limit placed on the amount to be paid in the event of a major loss and no coinsurance would be applied to limit recovery to a percentage of the total damages incurred. An upper limit to recovery, significantly above the replacement cost value of most homes, say at \$250,000, could be applied to establish a limit on the insurer's liability in the case of extraordinary losses or for purposes of reinsurance.

- 10.1 In considering consumer expectations and needs regarding coverage on the dwelling, the Committee concludes that *full replacement cost coverage* is a concept which the insurance industry as a whole should undertake to study and to offer without restriction in all homeowner's policies.

Under this coverage, each policyholder would be insured to full replacement cost value on the dwelling, including debris removal, rather than to the amount of insurance coverage carried. An amount of insurance would be specified for premium setting purposes only.

The adoption of this concept is made more practical with the development of better and more consistent guides for evaluating the insured value of homes for premium setting purposes and with the acceptance of the insurance to value concept by consumers. The Committee comments further on these latter two aspects in the next chapter.

2. Coverage on Contents

At the present time, most policies provide settlement for loss or damage to contents on an actual cash value basis. Certain companies offer replacement coverage to policyholders on a selected basis. In the Committee's opinion, the consumer's common expectation for recovery regarding contents is that it be provided on a replacement basis. The present practice, wherein some companies offer replacement cost coverage on contents on a selected basis, can become a method of "creaming" market share by offering this coverage only to the better risk policyholders.

However, it is apparent that full replacement cost recovery on contents without an upper limit is not a practical approach as the homeowner with a high value of contents would recover under the full recovery provisions of the policy without having declared extra value on contents for premium setting purposes. As a result, losses paid out by the insurance industry would exceed premiums taken in. Provision of full recovery on contents is further hampered by the inability to estimate the value of contents in individual homes through a uniform method of evaluation. There is therefore a need for an upper limit to be placed on coverage for contents, expressed either on a replacement cost or an actual cash value basis. Coverage limits can be set as a percentage of the estimated value of the dwelling or at a level chosen by the insured.

10.2 Many insurance companies at present do not offer the option of replacement cost coverage on contents. The Committee encourages the insurance industry as a whole to offer replacement cost coverage on contents to any insured wishing to obtain this option. In this way, the Committee feels that the industry will be responding more fully to consumer expectations in regard to recovery for contents.

3. Other Coverages

The Committee has a number of comments to make in regard to the other coverages commonly provided in a homeowner's package policy.

An essential feature of a homeowner's package is coverage for *liability* to protect the policyholder against financial loss arising from liability for bodily injury or property damage suffered by third parties. The Committee encourages the insurance industry to market an appropriate level of coverage for liability as part of all policies applicable to all residential and rental risks.

The Committee views coverage for *theft* as less essential than fire and related perils insurance since theft coverage protects the policyholder's contents, rather than the dwelling. As with contents coverage in general, the insurance industry should consider providing a greater choice of options and flexibility to the policyholder by providing higher deductibles or, in some cases, providing policies which exclude this coverage. These measures would contribute to the affordability of insurance to those unable to afford the purchase of a full insurance package.

There are certain coverages or lack of coverage in the homeowner's package of which the average consumer is likely unaware. For example, the consumer may be unaware of the availability of coverage for voluntary medical payments or the lack of coverage for damage caused by animals. These coverages or lack thereof should be made more evident to the policyholder who may in certain cases have the basis for a claim, but not be aware that he can recover.

While the Committee considers certain coverages to be essential and others to be desirable for the homeowner or tenant, it regards the responsibility for developing and offering better coverage standards as a matter for industry action rather than a matter for government regulation. In this section the Committee presents a number of its views regarding consumer expectations for coverage; it believes the industry has been slow to provide for these expectations in homeowner's policies currently in common use. The Committee believes, however, that the capability exists in the industry for introducing changes into the various component parts of the homeowner's policy and into the statistical plans that record loss experience corresponding to these component coverages.

B. THE NEED FOR A STANDARD POLICY

Insurance is not a homogeneous product, either in terms of coverage or price. As there is no complete homogeneity among insurance products, a standard policy could assist in comparison shopping and price competition by providing the buyer with a comparable product.

The standard policy does, however, have a number of drawbacks. It interferes with product innovation and it requires updating with changes in the risk environment. Furthermore, standardization can make consumers complacent and discourage their requests for advice; therefore the industry must still advise consumers regarding their need to extend coverage beyond the standard level.

Moreover, difficulty arises in defining what types of coverage should be provided as standard. Traditional usage has defined a variety of coverages and risk classes, but these need not be the most appropriate to the consumer's needs or expectations. Standardization may not assist the majority of consumers in price shopping as the standard policy may not meet their expectations of coverage.

The Committee has considered the need for an insurance product that meets consumer needs and expectations and also is structured in a way that provides some standard basis for price shopping. As a means of meeting both considerations, the Committee has examined the concept of a *core* coverage.

A *core* coverage can serve as a standard coverage to be offered by all insurers, either as a separate policy or as a component of a wider "package" of coverages. All insurers would be required to offer and quote a separate premium for this coverage. However, the insurer would not be precluded from incorporating the *core* coverage in a package policy nor from offering any other variety of policy. Therefore, the insured would continue to be free to choose any policy offered by any insurer in the Province without the *core* coverage as a component.

The concept of a uniform *core* coverage to be offered by all insurers would provide a basis for the consumer or for the Superintendent to obtain and compare quotes from a number of insurers on a uniform coverage basis. As a result the consumer would be assisted in price shopping among insurers. It is evident that the concept of a *core* coverage is meaningful for price-shopping purposes only if it is a practical, up-to-date representation of the majority of consumers' expectations for recovery and if, in fact, it will be purchased widely by consumers.

While there is no complete homogeneity among insurance products currently offered, there is substantial similarity so that the transition to a *core* coverage should not be difficult to achieve.

10.3 The Committee sees merit in the introduction by the industry of a standard *core* coverage to assist consumers in comparative shopping. The Committee encourages the industry to develop and offer without restriction a *core* coverage that meets the coverage expectations of the majority of consumers.

The Committee therefore suggests that the *core* coverage might be defined as:

- Coverage on the *dwelling* against fire and all major perils currently provided for in the majority of homeowner's policies; and
- Full replacement cost coverage on the *dwelling*, with no upper limit on recovery or alternatively a high upper limit, say \$250,000.

Further coverages, related to protection against liability or contents losses could as well be incorporated into the *core*, if the industry were satisfied that the formulation of these coverages met the needs of a majority of policyholders.

C. LESS COVERAGE FOR A LOWER COST OF INSURANCE

The Committee has found that there may be an impression among many consumers that they are buying more coverage than they need. Nevertheless, in many instances, it would not be in the best interests of the consumer to reduce his coverage to benefit from a lower cost of insurance. In particular, it would appear to be against the interests of the consumer to gamble that he will not experience a complete or catastrophic loss.

The Committee has also noted the concern that the industry does not provide the consumer with an adequate choice regarding how much or how little coverage he can buy. The industry, on the other hand, points out that the consumer can, from various policy forms on the market, exercise selection as to coverages and amounts of insurance, but warns that the aggregate cost of various coverages would exceed that of a single package policy. The Committee, however, finds that the emphasis on insurance to value and

package policies has reduced the availability of the more basic coverage forms.

The Committee comments below on its views regarding choice of amounts of coverage on the dwelling and on contents.

1. Amount of Coverage on the Dwelling

The Committee views insurance on the dwelling to be an essential form of protection and hence does not regard coinsurance by the policyholder at various levels of coverage to be generally desirable. However, it appears that some consumers may wish to insure only for low limits of coverage where the frequency of loss is greatest and to chance the payment out of their own pockets of some part of the damages in the case of major, but less frequent losses.

10.4 The Committee regards the choice of coinsurance at the top levels of coverage to be a false economy for the average consumer. The additional premium cost to achieve “insurance to value” is normally minimal, whereas the cost to the policyholder in sharing damages in a major loss can be substantial. A better solution for providing savings in premiums would be to provide a choice of deductibles on coverage to suit the pocketbooks of consumers.

2. Amount of Coverage on Contents

A common complaint heard by the Committee is related to the lack of choice available to the consumer concerning the limits on contents coverage in homeowner’s package policies. Whereas the tenant is generally able to state a value for which he wishes to be covered, the limit on contents coverage in the homeowner’s package policy is established as a fixed percentage of the insured value of the home, usually in the range of 40 to 60 percent. In many cases the policyholder believes the value of his contents to be substantially less and therefore feels he should not be required to pay for coverage in excess of his value of contents.

The Committee recognizes that the insurance industry cannot establish rates readily or objectively for various levels of contents coverage under traditional ratemaking systems. Under the present statistical reporting procedures, loss experience is reported in the context of the homeowner’s policy as a “package” rather than for the individual components of coverage within the “package”.

10.5 The Committee believes that it is desirable to have an availability of a choice of amounts of coverage for contents. Such choice should as well be extended to include increased values for special items such as jewellery, furs, coin or other collections and so on, or to provide for replacement cost coverage, without the need for separate endorsement

or declaration. By being given a choice of coverage limits on contents, the consumer may in fact consider more carefully the extent to which his investment in contents is put at risk. The consumer will then insure accordingly.

- 10.6 In general, the Committee supports the availability of greater choice in coverages, including the “unbundling” of package policies to permit the consumer to exercise a greater choice among the component coverages in the policy package. The Committee encourages the industry to provide this wider choice, while assisting the consumer to shop by means of better information provided by the sales intermediary and by the development of a *core* coverage.

CHAPTER 11

Cost in Personal Lines

A. CONSUMER EXPECTATIONS REGARDING COST

In considering the matter of availability, the question that naturally follows is what should the consumer have to pay for insurance protection? Insurance is socially useful as a means of protection only if it is readily available at reasonable cost to the consumer. It is nevertheless difficult to define 'reasonable' to suit the pocketbooks of all consumers.

In demonstrating a commitment to provide protection against risks at a reasonable price to all consumers in Ontario, the insurance industry must take into account consumers' expectations regarding cost of coverage. The Committee believes that the following are among these expectations:

1. The consumer wants to pay the least cost for the coverage he needs. The consumer may be willing to trade less coverage or less service for a lower cost.
2. The consumer wants to be able to price shop.
3. The consumer expects that insurable values and corresponding insurance costs should not be unduly out of proportion to the market value of the home or property insured.
4. The consumer wants to be assured that the price he pays for insurance coverage is fair relative to other risks of a similar nature. He may want to know what risk factors affect the premium he pays.

In previous Parts of this Report, the Committee discussed various aspects of cost containment in regard to loss settlement costs and operating costs and commented in particular on required improvements in the functions of marketing, underwriting and policy processing and claims handling. Cost containment in industry operations is necessary to demonstrate efficient management in the general insurance industry and hence to ensure that the consumer is not paying too much for coverage provided by insurers in this Province.

The Committee devoted the previous chapter to a discussion of the consumer's expectations regarding coverage. The lack of complete homogeneity among insurance products for the homeowner's or tenants' protection was regarded as an obstacle to effective price-shopping. The Committee provided a suggestion to the insurance industry for the introduction of a *core* coverage to assist the consumer in obtaining the best or least cost for the coverage he feels he needs.

In this chapter, the Committee continues its consideration of the matter

of cost by examining two further consumer expectations, under the headings of:

- Insurable Values and Affordability. Included under this heading is a discussion of the insurance to value concept, the process of evaluation of insurable values, the implications of market value—replacement cost differences and the concept of a minimal or ‘bare-bones’ policy.
- Cost Distribution According to Hazard. Included under this heading is a brief outline of the ratemaking process in personal lines of insurance, the Committee’s expectations regarding the structure of rating classification systems and the use of discounts or surcharges by the insurance industry.

B. INSURABLE VALUES AND AFFORDABILITY

1. Insurance to Value

In general terms, premiums for homeowner’s and tenant’s coverage are determined as the product of a class rate for coverage multiplied by the amount to be insured. The amount to be insured or the insurable value is determined as the replacement cost for dwellings and as the actual cash value of contents, that is, the cost of replacing the property minus any depreciation.

When insurable values increase, premium costs go up. Therefore, when inflation drives up replacement costs, premiums increase although the rate for coverage may remain constant. The factors affecting the rate for coverage are discussed in the next section.

Inflation is a factor outside the control of the insurance industry. To cope with inflation, the industry has promoted the *insurance to value* concept. Insurance to value attempts to make certain that policyholders are covered for full recovery in the event of a major loss. On the other hand, should the policyholder fail to keep the insured amount in line with the replacement cost of his dwelling, the optional loss settlement clause in his policy will apply, as discussed in the previous chapter, and his recovery may only be partial.

Insurance to value also avoids the problem for insurers of an adverse loss to premium ratio created when a property is underinsured and small, but frequent, partial losses erode the premium base. If in times of inflation, the costs of partial losses, which form the bulk of losses, increase but sums insured do not increase in the same proportion, then loss costs per \$1,000 of policies written increase and the insurance *rate* rises to cover losses. An insurer with a large portfolio of underinsured dwelling risks is likely to be forced to sell at higher, non-competitive rates.

In addition, *insurance to value* is important from the viewpoint of the insurance pool as a whole. The person who underinsures violates the second

principle of insurance by failing to pay into the pool in proportion to the risk he imposes on the system. Consider as an example, two identical dwellings with rebuilding costs of \$40,000 each. One is insured to full value, the other is insured to \$20,000. While both are similar risks, one is contributing only one half of the premium to the total insurance pool, as the rates applied to the respective amounts of insurance carried correspond to the full value of the dwellings and are therefore identical.

Inflation, the application of the *insurance to value* concept and the resultant steady premium increases in recent years have aggravated affordability problems for certain policyholders and generally caused complaints by consumers regarding continual increases in premium costs. These complaints and affordability problems are related to two matters discussed below. The first concerns overinsurance resulting from the cost evaluation procedures used by insurers to determine insured value. The second arises when the *insurance to value* concept forces a homeowner to insure for amounts that exceed the market value of the property.

2. The Evaluation of Insurable Values

The *insurance to value* concept has been promoted by the insurance industry in response to inflationary trends affecting rebuilding costs and has required the insurance industry to examine its traditional methods of evaluating the insurable value of the residential property. At the same time it has contributed to a persistent problem in personal lines, that of overinsurance. These two matters are interrelated.

It is first important to note that there is no precise method of calculating the full insurable value of a home. Even an appraisal by a professional in this field may not provide an accurate figure for the replacement cost of a home should it be destroyed and rebuilt within a short time after the appraisal. In any event, the cost of an appraisal is prohibitive to most homeowners seeking insurance coverage.

As a result, insurance companies have developed cost guide methods for determining the approximate rebuilding cost of a dwelling. The most frequently used method in the past assigned a cost of rebuilding per square foot of the ground floor or living area. Other methods were based on a construction cost applied to the number of rooms and similar variations. If merely approximate insurance requirements were desired, one method was probably as good as another.

The Insurance Bureau of Canada as well as several individual insurers have examined the evaluation process and recently developed new cost evaluation procedures. The I.B.C. publishes a "Home Evaluation Calculator" which is a relatively detailed method of evaluating insurable values using cost data produced by a professional appraisal firm. The input data on costs are continually monitored and consist of some 86 elements of material, la-

bour and management costs, which are weighted and adjusted to reflect types of construction in different locations. The cost data relate to new construction on a clean site and therefore do not truly reflect the somewhat higher costs of damage repairs and exclude the component of damage associated with debris removal. The value of this method is that it permits exact comparisons of costs over different periods of time.

The Committee is satisfied that the insurance industry has made meaningful improvements in the methods of calculating and updating insurable or replacement values, based on sound analyses of construction costs and changes in these costs. Yet imprecision in these methods continues to exist because they derive an average cost of rebuilding for specified types of residential properties and not a cost related to individual properties. As a result, the individual policyholder may decide to insure above the calculated insurable value to protect himself against a shortfall in replacement recovery in the event of a total loss. In many cases, this precaution results in overinsurance.

Similarly, the imprecision of calculating insurable values affects mortgage lenders' requirements for insurance and can contribute to overinsurance and an unnecessary high cost to insurance as described below.

3. Mortgagee Requirements for Insurance

Homeowners may in some cases be forced to overinsure to guarantee that mortgage holders are fully secured or protected against loss up to the value of the loan. The residential property insurance contract includes a standard mortgage clause under which the insurer obligates itself to protect the mortgagee against any loss that endangers his insurable interest in the property. The Committee has encountered complaints from consumers and the insurance industry that some mortgage lenders insist that insurance be purchased to the full value of the mortgage loan. This requirement is intended to safeguard the mortgage lender's interest in the property, but it may result in a requirement for more insurance than is reasonably needed to protect the mortgagee's security.

The Committee has solicited comment on this matter from a number of associations representing major mortgage lenders, such as the banks, trust companies and credit unions. Their response indicates that the normal practice of the larger lenders is to require the mortgagor to keep the property insured in favour of the lender for the full replacement value of the building. This means the property must be insured for at least the amount of the mortgage or the full insurable value of the buildings, whichever is the lesser.

Despite the general practice of the major lenders, the Committee is informed that other mortgagees often adhere to the practice of requiring insurance up to at least the amount of the loan. This may mean the inclusion in the amounts insured of the value of land and foundations which remain in

the event of a damage claim. This practice is applied by the banks in the case of N.H.A. "E" type mortgages, where C.M.H.C. does not estimate a breakdown between land and buildings. Therefore, subject to the advice of the applicant's insurance agent, the bank requests that the full amount of the insurable loan be covered.

The Ontario Mortgage Corporation follows the same practice of requiring insurance to the mortgage loan amount which includes a portion of the land value. The required coverage is reduced to the building value only, in the case of condominium blanket mortgages where the building valuation is supported by an accredited professional appraisal on an annual basis. In the case of single-family dwellings where appraisals are impractical in terms of cost, the policy of the Mortgage Corporation may result in overinsurance. This policy is justified by the Corporation on the premise that it protects against the possibility of reduced insurance pay-outs, in effect, co-insurance, in the event that rapidly rising construction costs surpass the owner's opinion of the true market value.

4. Alleviating the Overinsurance Problem

Acknowledging the imprecision of cost evaluation methods, many insurers guarantee that if the policyholder insures his home for an amount derived by that company's approved cost evaluation procedure, the insured will be considered to be "insured to full replacement cost value". This guarantee relieves the consumer of the need to add a few additional thousands of dollars in amount of coverage as a precaution in case of catastrophic loss. In addition, it relieves the mortgage lender of any reason for requiring insurance to the value of the loan.

The Committee objects to the consumer bearing the risk that he might be underinsured. When the consumer expects to buy full value coverage he should be able to obtain this coverage without the risk that the value of his property may not be estimated properly. This risk is eliminated with the guarantee described above and also by the proposed full replacement cost coverage defined in Chapter 10.

11.1 To protect the insured in the event of a major loss, the Committee has previously in this Report encouraged the insurance industry to offer full replacement cost coverage in all homeowner's policies as the basis for recovery of damages to the dwelling. This concept is of further value in alleviating the problem of overinsurance and making the insurance product more affordable. Accordingly, the Committee endorses the concept of a guarantee in the policy for full replacement cost coverage, including debris removal, to be provided whenever the policyholder insures to the value calculated according to a cost evaluation process approved by his insurance company. The Committee strongly encourages all insurers to provide this guarantee in their poli-

cies and encourages the Insurance Bureau of Canada to set this matter as a guideline for its members to follow.

5. Uniformity in Insurable Values

At the present time, many insurers continue to use their own individual procedures for calculating insurable values, in some cases as a means of control over the premium setting process. That is, an insurer may assign a higher insurable value to a specified type of home than might be derived on the basis of a uniform, industry-wide cost evaluation guide. The Committee's comments on this lack of uniformity follow.

11.2 An important aspect of the cost of insurance is the calculation of the insurable value of the home. The Committee discourages individual companies from calculating this component of the premium base on considerations which more rightly belong in the calculation of the rate. In the Committee's view, the calculation of insurable values should be an objective process, based on a relatively well defined set of material and labour cost inputs.

11.3 The Committee therefore encourages the general insurance industry to develop and apply consistently a uniform cost evaluation procedure for determining the insurable value of properties and the periodic inflationary factors used to update the calculation of insurable values.

At the present time, insurable values derived for premium setting purposes vary among individual insurers. This variability contributes to some confusion on the part of the consumer in the process of comparative shopping.

6. Market Value—Replacement Cost Differences

A difficult affordability problem arises when significant differences exist between market value and replacement cost. When the market value of a home is less than its replacement cost value the insurance to value concept, which is based on the replacement cost of the dwelling, forces the owner to insure for amounts that exceed the selling value of the property. Owner-occupants of large, older homes with a low market value due to location or state of disrepair, have been particularly affected by recent large upward re-valuations of their homes to account for the high cost of repair or rebuilding of such homes. In many cases the low market value of these homes reflects the low income of the owner-occupants. The premium burden associated with insurance to value may be too great for such persons, creating an affordability problem. This problem is not easily resolved within the insurance system.

7. Alleviating the Affordability Problem

The Committee sees three measures available for alleviating this affordability problem:

- government subsidization of insurance for low income homeowners or other government involvement in the provision of insurance;
- greater use of deductibles or policy exclusions;
- availability of a basic or minimal coverage policy.

Government Subsidization

The Committee does not view the affordability problem in the personal lines of insurance to be significant at the present time in this Province. Despite the inevitability of complaints in an inflationary period, the Committee sees little evidence of widespread problems of affordability or exorbitant premium increases which necessitate direct government intervention in the provision or subsidization of insurance protection. In general, it is the Committee's opinion that the government should not involve itself in the direct subsidization of insurance premiums per se, as they represent only a small part of the general affordability problem faced by the low income consumer.

Reduction in Coverage

The affordability of insurance costs can be improved by the consumer's willingness to sacrifice some measures of coverage or service. In its First Report, the Committee discussed the impact of a higher deductibility feature on total automobile insurance costs through the removal of frequent small claims and the elimination of the disproportionately high adjusting and processing expenses associated with small claims. It was clear that the buyer of a higher deductibility amount would be placing a lesser burden on the insurance system and hence increasing affordability in the general insurance system as a whole and for himself individually. A similar result could be achieved by the insurance buyer in choosing a policy with exclusions which restrict coverage to the more essential recovery situations.

11.4 To cope with the bulk of complaints regarding premium costs, the Committee repeats its encouragement to the insurance industry to educate the public to greater use of deductibles and to market this concept actively in personal lines. In so doing, the cost of insurance can be lowered for the individual consumer and for the insurance system as a whole, with the elimination of minor claims.

11.5 Furthermore, the Committee reinforces its recommendations to the general insurance industry that it provide the consumer with a greater choice of coverage and service to allow him to reduce the cost of his insurance, if he so desires or if he so requires because of income constraints.

The Minimal Coverage Policy

In those cases where the affordability problem is more acute, suggestions have been put forth for the availability of a "bare bones" or minimal coverage policy at a low overall premium cost.

Several insurers in the United States have introduced minimal coverage policies to provide protection on high risk, low market value properties, where the cost of full replacement cost coverage and other normal homeowner's policy features would be prohibitive to the owners. The F.A.I.R. plans in the United States also provide a reduced coverage dwelling policy, without the full coverage features of the typical homeowner's package. Using American examples, a minimal coverage policy frequently:

- excludes coverage for theft;
- substitutes "repairs up to an acceptable living standard" for full replacement cost coverage; and
- has limited perils coverage.

In Canada, a proposal before the Superintendents of Insurance in the Provinces suggests that legislation be enacted to require insurers, as a condition of their being granted a licence to transact fire insurance, to make available a basic form of fire insurance and not to refuse this form to any applicant who would be insurable under any of the company's other forms. As suggested in the Superintendents' proposal, basic insurance would protect only against "losses of crippling dimension from perils which threaten total destruction". Features of the proposed basic insurance include:

1. Specific amounts of insurance apply separately to the main residence and to household contents while contained in the main residence against fire and explosion.
2. There is no coinsurance but settlement can be on a replacement cost basis for the building only, if it is insured for a stated percentage of its replacement cost at the date of loss.
3. No extension applies for outbuildings but these can be specifically insured as separate items.
4. No extensions for realty fixtures or landscaping.
5. No extensions for extra living expenses.
6. No extensions for household effects while outside of or away from the residence.
7. A deductible for household effects while outside of or away from the residence.
8. The policy may be extended to cover against another set of perils for an additional premium.
9. There is no coverage for roof coverings under the windstorm feature of the extended perils unless damage is done at the same time to the roof structure itself.

11.6 The Committee recommends that the insurance industry make available a "bare bones" or minimal coverage policy. While the demand

for this coverage may not be extensive, the Committee feels that availability of this coverage is desirable for those consumers who either choose to take this coverage or are forced to take such coverage because of income constraints.

The Committee proposes that both the industry and the Superintendent of Insurance cooperate in formulating the “bare bones” policy since protection under this policy would be at a minimum.

C. COST DISTRIBUTION ACCORDING TO HAZARD

1. The Second Principle of Insurance

The Committee observed earlier that, in its opinion, the consumer wants to be assured that the price he pays for insurance coverage is fair relative to other risks of a similar nature. The Committee further believes that affordability for specific risks can be improved by a fairer distribution of costs according to hazard.

In Part III the Committee repeated the responsibility of the industry to adhere to the second principle of insurance—that the cost of insurance to individual policyholders be commensurate with the risks they impose on the insurance system. The second principle of insurance dictates that “like” risks be grouped and charged the same premium. In its studies into automobile insurance, the Committee found that “like” risks can be variously defined, depending on the choice of criteria by which to group risks.

In its First and Second Reports the Committee called for the need for a classification system that is entirely objective and actuarially sound so that the calculation of premiums is based on a set of objective, clear and understandable criteria. In continuing its study into the property and casualty insurance sector, the Committee finds that, both in automobile and in residential lines of insurance, the criteria for “like” risks have, over time, become broadly defined, allowing risks to be grouped into a relatively limited number of standard risk classes. However, the Committee finds that in practice many aspects of the ratemaking system used in both these lines are arbitrary or subjective in that rating factors are applied without proper statistical justification.

2. Statistical Reporting Plans

The Committee finds that there is a standard format for reporting loss experience in the automobile lines of personal insurance, although insurers do not apply the standard rating factors in a consistent fashion. Similarly, in residential lines, a standard format for reporting loss statistics also exists under the I.B.C. Brown Book or Personal Lines Statistical Plan. The reporting of statistics under the Brown Book is voluntary and not mandatory as in the automobile insurance sector.

An insurer following precisely the risk classification system defined for purposes of reporting loss experience under the I.B.C. Personal Lines Statistical Plan would charge a different rate according to the following risk categories:

- eight categories of geographical territory;
- five categories of town protection grade, referring to the quality of firefighting services available in the community in which property is located;
- over thirty variations of type of policy and coverage;
- three distinctions of occupancy type;
- three deductible amounts.

The statistical plan also requires insurers to report data on losses under 23 kinds of loss categories as well as some further information. It is apparent that the Personal Lines Statistical Plan does not take into account any detailed, individual features of hazard or lack thereof, such as property maintenance, installation of safety features or construction features of the dwelling.

3. Ratemaking

The premium in personal property lines is the product of the class rate and the insured value of the property. The classification system for personal property lines applies in determining the rate used in premium calculation, but not directly to the eventual premium.

The Insurers' Advisory Organization produces advisory "pure" premium rates, without allocation of expense costs, based on the data gathered by the I.B.C. reporting system. In practice, companies deviate from the "pure" premium rates advised by I.A.O. In some cases they derive their own rates based on the Brown Book risk categories and statistics but more often they base their rates on their own loss experience and on their own classification system. As a result, insurers may be applying rating factors on which there may not be sufficient or accurate loss cost data.

For example, some insurers may apply a surcharge for substandard risks, such as homes of poor construction or in a state of disrepair; for abnormal exposures, such as a history of previous losses or homes in areas indicative of a high theft exposure; or for special hazards, such as wood-burning heaters. These factors are not accounted for in an objective, industry-wide statistical plan.

On the other hand, a few insurers have associated the installation of smoke detectors with reduced hazard by providing a discount to policyholders who install the detectors. However, the ability of smoke detectors to reduce the amount or extent of damage as a result of fire is not yet statistically

documented because widespread installation is only a recent phenomenon.¹ Other companies provide discounts to policyholders in regard to non-smoking or other group characteristics. A special situation of discounting arises in regard to group plans as discussed in Chapter 8.² Hence a ratemaking system that applies surcharges or discounts on the basis of statistically unsupported criteria may not, when eventually tested, meet the Committee's criteria of objectivity and clarity.

4. Observations on the Rating System in Personal Lines

The Committee is concerned that the rating classification systems used in practice by insurers writing personal lines of insurance are not adequately objective and not uniform. Freedom to set premiums on the basis of individual rating systems permits individual companies to:

- apply rating factors on which there may not be sufficient or accurate loss cost data;
- “cream” the market by lower rates or discounts applied to favourable risks;
- “red-line” or avoid sales in high risk territories by non-competitive pricing and by application of discounts in favourable territories only.

Furthermore, the Committee is concerned that the multiplicity of rating systems in effect in the Ontario market complicates the ability of the consumer to understand whether he is paying a fair price. The consumer finds it difficult to understand what factors influence the price for apparently similar, not to mention slightly differing, coverages available from competing insurers.

The Committee is also concerned that the factors for which data are gathered in the I.B.C. Personal Lines Plan do not distinguish residential properties by features of hazard, except to a limited extent by:

- occupancy, as a surrogate for a standard of maintenance or care; and
- territory and town protection grade, as a surrogate for various conditions such as housing standards, theft incidence and the like, as well as a measure of fire protection.

Individual characteristics which may affect the incidence of loss, such as safety devices, burglar alarm devices, smoke detectors and certain construction features, are not included in the Personal Lines Statistical Plan and therefore are not applied consistently among all companies in the rating of risks.

1. Some evidence is available in a study titled “Smoke Detectors in Ontario Housing Corporation Dwellings”, Ministry of Housing, January 10, 1978.

2. *Supra*, page 129.

In general, the Committee finds that the Personal Lines Statistical Plan as presently structured is not flexible and does not adapt to inclusion of data on newly identified or suspected risk factors. The data presently collected in the Plan reflect rating criteria that were deemed appropriate when they were first established and once set have rarely been challenged. The current practice of many insurers in rating on factors not included in the Plan indicates to the Committee that the industry recognizes that deficiencies exist in the classification system of the Plan and hence points to the need for identifying new or better risk categories in an updated Personal Lines Statistical Plan.

11.7 The Committee concludes that the industry, in meeting its responsibilities to the Ontario consumer, should recognize the need for universal reporting of loss costs in personal lines. It encourages the few companies who at present do not report their loss statistics under the I.B.C. Brown Book or Personal Lines Statistical Plan to participate in this reporting Plan.

11.8 The Committee also encourages the industry to participate in a review of the classification system presently in use in the Brown Book to determine whether the classification system as traditionally developed is appropriate to current risk environment conditions. The Committee in particular recommends that the industry address the following questions:

— Are a sufficient number of territories identified?

— Does the town protection grade category truly identify loss costs as a result of firefighting standards or is it perhaps a surrogate measure of other community living standards, such as age of housing, extent of vandalism and crime and so on?

— Can the system be made more understandable to the consumer?

11.9 The Committee also encourages the industry to review the classification system in the Brown Book to determine whether other factors can be identified for incorporation in the Plan as the basis for lower rates corresponding to individual efforts at hazard reduction. The industry should undertake to examine whether non-smoker discounts, smoke detector discounts or certain group discounts can be recognized as objective, uniform cells within the classification system.

11.10 The Committee suggests that statistics corresponding to a potential “discount” or “surcharge” factor be collected on a uniform basis for an appropriate period of time, to establish the validity of this factor as a rating cell. If analysis of the relevant statistics does not identify a lower cost of losses associated with the factor, then the Committee recommends that discounts or surcharges should be discontinued in practice. If the statistics prove a lower or higher cost relationship,

then the factor affecting loss costs could be incorporated permanently into the statistical reporting system.

- 11.11 The Committee does not at this time believe it is necessary or desirable for the Superintendent to impose a rating classification system on the industry in personal lines of property and casualty insurance. Rather the Committee relies on the industry to establish a rating classification system that is *fair and suited to the current risk environment*. The Committee expects all insurers to determine their rates on the basis of this universal classification system and to incorporate any new factors that affect risk as described above.

CHAPTER 12

Availability, Coverage and Cost in Commercial Lines

A. THE GOVERNMENT INTEREST IN COMMERCIAL LINES OF COVERAGE

The previous three chapters were devoted to the topics of availability, coverage and cost in personal lines of property and casualty insurance. In the Committee's opinion, the commercial insurance buyer has the same expectations regarding insurance as the personal lines buyer, that is, he expects:

- insurance to be available when he needs it;
- coverage to be available best suited to the needs of the business; and
- insurance to be available at reasonable cost.

This chapter therefore deals with these expectations in the context of commercial lines of insurance.

Government interest in availability of commercial insurance coverages at reasonable cost arises because there is a general need to protect business activity in this Province from the effects of catastrophic losses. The destruction of a business premises is a financial set-back to the owners of the business and, furthermore, it affects the community through loss of jobs. Stability of business enterprises, both small and large, is a matter of major concern to the Ontario public: stability in employment and earnings is needed for economic growth. While in a competitive market system, it may not be essential to protect every individual business enterprise to ensure that it stays in business, it is desirable to protect overall business activity. The government therefore has an interest in the way in which the private insurance industry provides this protection through the insurance mechanism.

The necessity of insurance to the business community has been established over time. Insurance is necessary for risk-taking to occur; for example, insurance is necessary to reduce the risks associated with new capital investment or new business ventures. With the increased sophistication of technologies, insurance is becoming increasingly necessary because of the large accumulation of insurable values at single locations. In most cases, insurance is the most economical and practical means of assisting businesses to survive potential losses and carry on operations. Many companies do not have the internal resources to utilize self-insurance or other loss-absorbing techniques effectively.

Differences are recognized, however, in the degree of government "concern" that is necessary in regard to commercial risks. The commer-

cial insurance buyer in a large organization is perceived to be knowledgeable and therefore less inclined to need regulatory protection in regard to his purchase decision and in regard to the availability of insurance. On the other hand, the small businessman buying insurance may be no better informed about the insurance process than the average personal lines buyer and may expect some degree of regulatory protection regarding availability, cost and coverage.

Given that there is some degree of government interest in ensuring the availability of commercial lines of insurance, the Committee comments below on the following matters:

- the role of self-insurance for commercial risks;
- problems regarding availability brought to the Committee's attention;
- placement of insurance, with unlicensed insurers in offshore markets;
- efforts by insurers at filling in gaps of availability; and
- cost of commercial coverages.

B. ROLE OF SELF-INSURANCE FOR COMMERCIAL RISKS

1. Advantages of Self-Insurance

In certain cases, the commercial enterprise can forego insurance protection and benefit from a programme of self-insurance. As a result, availability of insurance from the insurance industry is of less concern to these enterprises. There are various forms of self-insurance programmes related to specific company needs:

- Losses can be paid as they arise;
- Funds can be reserved for future losses; and
- Other self-insurance programmes can be undertaken individually or in concert with other business organizations.

The choice of programme depends on the need of the enterprise to reduce the chances of being unable to cope with a loss on its own.

A number of benefits accrue from self-insurance. Self-insurance encourages loss control. Self-insurance on small losses through deductibles makes insurance on higher coverages more available and affordable. Costs in self-insuring may be less because payout is restricted to the actual cost of a loss at the time it happens: the firm is not required to contribute in its premiums to the overhead of the insurance company or share in the expected claims costs of other members in an insurance pool. Formal self-insurance mechanisms, such as captive insurance companies, have various advantages for the business firm, such as improved cash flow, potential tax advantages, investment income contributions and so on. Depending on the circumstances, commercial buyers are either forced, through lack of avail-

ability or high premium costs, or they decide on the basis of the above factors that it is to their advantage to self-insure.

2. Captive Insurance Companies

The formation of a captive insurance company as a formal means of reserving funds is a type of self-insurance programme which is receiving increased attention. In some cases the captive insurance company may be licenced if it undertakes to conduct insurance business, such as reinsurance, on behalf of others. Typically the captive is not licenced and is usually located offshore. As a result, there is no supervision by the Superintendent to ensure solvency, proper operations, fair funding and so on to protect the commercial enterprise or those who might have cause to demand compensatory damages from the commercial organization.

3. Lack of Protection

Whatever the form of self-insurance, except for the case of a licenced captive, there is a lack of *protection for the self-insured*. Accordingly the choice to self-insure should be based on a proper level of information and knowledge, either internally at the corporate level or externally by reliance on the advice of an experience agent or broker. Generally, commercial enterprises are expected to have a sufficient level of knowledge to make an informed decision on this matter.

In addition, self-insurance may result in a lack of *protection for third parties*. It may be desirable to restrict self-insurance in certain liability situations—to protect third parties. For example, in the Second Report the Committee concluded that self-insurance should not be allowed with regard to third party liability coverage and Accident Benefits coverage, even in the case of business corporations with sufficient assets. It is nevertheless difficult to extend the concept of compulsory insurance to the commercial market because of the variety of liability circumstances which must be covered, resulting in a variety of coverage and cost situations.

- 12.1 In considering the availability of insurance for commercial organizations, the Committee recognizes that the commercial enterprise can, in certain cases, forego insurance and benefit from a programme of self-insurance. In general, the Committee views the commercial business community to be knowledgeable enough to engage in self-insurance in regard to protection of business property or protection against the consequences of business activities. More specifically, the Committee encourages greater use of deductibles as a practical means of reducing insurance cost to the commercial buyer and of reducing the overall burden of losses on the insurance system. The Committee encourages the insurance industry to actively promote this form of partial self-insurance.

12.2 The Committee notes the current interest in the formation of captive insurers. Although activity in this regard is limited among Ontario business firms, relative to the interest in the United States, the Committee recognizes that there are financial advantages to the location of captive insurers in certain offshore locations. The Committee views the formation of captives in this Province as more desirable than location offshore in order to maintain the reserve and investment base of the captive in this Province. However, the Committee is not prepared to recommend specific incentives to attract captive formation in this Province and does not believe that such action is needed at the present time.

12.3 The Committee has given consideration to the need for supervision by the Superintendent of Insurance of certain self-insurance mechanisms, particularly in third-party liability situations. The Committee concludes that the Superintendent should have the authority under The Insurance Act to examine and report upon the adequacy of self-insurance plans covering the liability of business firms or professionals operating in this Province, should he find it necessary to do so in certain circumstances.

The Committee addresses further recommendations regarding self-insurance for *liability* situations in Part IX of this Report.

C. PROBLEM AREAS REGARDING AVAILABILITY

1. General Problems

In a number of submissions before the Committee, risk situations were identified where there are at present some problems regarding availability of coverage. A review of these situations follows.

The Toronto Insurance Conference in its submission to the Committee indicated that the market search process for finding a placement sometimes runs into problems in the following areas:¹

- “jumbo” accounts, where capacity is sometimes a problem even in world-wide markets;
- some non-conventional insurance classes, such as kidnap and ransom, directors’ and officers’ liability, some errors and omissions classes, political risks insurance, aviation products, bankers’ blanket bonds, all of which are written by specialty markets so that there is limited capacity available;
- other non-conventional classes which are completely unavailable, for example, patent infringement; and
- certain product liability risks.

1. Exhibit 31.

The Ontario Risk and Insurance Management Society provided another listing of risks which its members found to be a problem to place on the Canadian market, as follows:

- “many insurers do not write petrochemical risks;
- insurers are very restrictive in providing cover for large warehouse risks where concentration of values and high piling have brought about severe demands for very expensive protection improvements;
- directors’ and officers’ liability coverages are written only by a few companies, who are very selective in their requirements;
- architects’ errors and omissions coverage;
- bankers’ blanket bonds (very high deductibles demanded, very few markets, and constantly escalating costs);
- environmental impairment—almost *uninsurable*.’’¹

O.R.I.M.S. pointed to several other problem areas in its submission:²

- difficulties in interesting insurance markets in risks where there are such exposures as animal feeds, pharmaceuticals, chemicals, petroleum, machinery—and where there is a U.S. or potential U.S. exposure;
- problems in obtaining top layers of liability coverage and problems in cost;
- apparent lack of capacity to achieve required catastrophe limits. Lack of competition because so few companies are interested in writing;
- an example of market restriction can be found in the steel industry where Factory Mutuals are in effect the only available market for the large property risks that are involved;
- utilities with major exposures fall short of obtaining their total requirements on the Canadian market;
- when insureds combine their property needs with those of catastrophic business interruption exposures, there are top level areas which cannot be covered.

The Office of the Federal Superintendent of Insurance reported to the Committee’s consultants that companies seeking exemptions from the Excise Tax—applied to business, other than marine, placed with unlicensed insurers through brokers in Canada—declare there are problems with inability to obtain coverage in Canada, in regard to:

- general liability lines for excess limits coverage, with oil and gas risks specially cited;
- professional errors and omissions lines, with trust officers’, ac-

1. Exhibit 59.

2. Ibid.

- countants' and professional engineers' errors and omissions insurance cited as problem areas in the 1975-1977 period;
- certain substandard risks in property lines; examples were given of old hotels and sawmills in the northern parts of the British Columbia market.

2. Problems in the Liability Area

Various forms of liability insurance were identified in the above listings as problem or difficult-to-place areas. Yet, to protect third parties, the Committee is of the opinion that liability coverage should be readily available and should be encouraged as preferable to self-insurance, particularly at higher limits. Problems brought to the Committee's attention affecting the availability of certain specific forms of liability insurance, are outlined below.

Product Liability. Movement of goods across borders may create problems of jurisdictional differences affecting claims and size of product liability awards. Such problems are not encountered by the more normal general liability risks associated with the conduct of business in the Province.

In addition, in many jurisdictions, uncertainty exists in the legal climate affecting liability. The trend in many jurisdictions has been toward strict liability. In Ontario, the Ontario Law Reform Commission is currently working on a report to examine the laws regarding product liability in this Province.

Availability of product liability coverage is sometimes a problem because underwriting knowledge is limited with respect to many product areas. This is true at the reinsurer as well as at the primary level. In recognition of the need for better information, some reinsurers have recently begun to devote special research staff to evaluate the loss potential of certain groups of products.

A survey conducted by the Canadian Manufacturers Association (C.M.A.)¹ in late 1977 indicated that only 6 percent of insuring companies had difficulty in renewing their product liability coverage in recent periods. However, half of the insuring companies reporting to the survey from across Canada had faced dramatic increases in the cost of obtaining coverage. One-third reported that difficulties in finding coverage or dramatic price increases were due to the fact that they exported to Western Europe or the United States. Despite reports of high price increases, only 9 percent of insuring firms found that their product liability insurance costs exceeded one percent of their gross annual sales.

1. See Appendix B, Exhibit 70 for reference.

Excess Liability Limits Coverage. The Committee's impression is that the Ontario market may be too small, without collective industry underwriting, to support the best underwriters in this area. Special skills are required to price risks for excess coverage. There may also be too few risks in the Ontario market to spread losses that call on excess limits coverage.

Professional Liability. The Committee expects that the size and frequency of liability claims should be related to the laws and judicial practice in each jurisdiction. However, trends in awards in other jurisdictions appear sometimes to influence the underwriters' loss projections in this Province.

Many groups, such as doctors who self-insure through the Canadian Medical Protective Association, lawyers who insure as a group under the auspices of the Law Society of Upper Canada, and accountants, who have been forced to seek offshore placements, have had difficulty in placement or have decided to self-insure.

There are recent indications that some of the problems in regard to availability of professional liability coverage are easing, both in the United States and in this Province. On the other hand, product liability coverage is becoming a matter of greater concern in the United States and some manufacturers are finding that products liability insurance has become unaffordable or, in some cases, unavailable. The problem, as indicated by the C.M.A. study discussed earlier, is of lesser proportions in Canada. While the solutions for this problem include the reform of liability laws and the manufacture of better and safer products, there is likely sufficient basis for stating that another underlying cause of the problem is the inadequacy of insurance rate-setting mechanisms. There appears, for example, to be no separate industry-wide data base for product liability losses either in the United States or in this Province.

The Committee considers lack of availability to be a particular problem when it occurs in the area of liability coverage. Since liability coverage protects third parties against non-recovery of damages incurred, the government interest in availability is increased. In the Committee's opinion, an insurance industry which fails to meet market demand for liability coverage demonstrates a certain lack of commitment to the public interest.

3. Overall Observations Regarding Availability

For the most part, witnesses before the Committee have been satisfied that the domestic insurance market is adequate for all but extraordinary needs. These extraordinary needs, where market restrictions apparently do exist, fall into risk categories such as:

- top layers or excess limits of coverage;
- areas with potential for unknown hazard, such as chemical risks;

- areas with potential for large claims and usually a high frequency of claims, such as certain errors and omissions coverages;
- large concentrations of values, such as major warehouse risks, mines, and petrochemical property risks.

For the most part, the market restrictions are a matter of:

- lack of domestic underwriting expertise;
- a small volume of business in the Ontario or all Canada market;
- few competing insurers in certain categories of risk;
- poor profitability in certain lines;
- rejection of certain substandard risks; and
- lack of a meaningful statistical data base for underwriting purposes.

It is likely that most market restrictions are the result of the unwillingness of some or all insurers to participate in markets in which they lack the expertise, the data or the alacrity to evaluate properly what seem to be specialized or “high exposure” risks. Unwillingness to participate may also be the result of a relatively small volume of business in a particular line of coverage or for high coverage requirements. This appears to be the problem in non-conventional classes such as bankers’ blanket bonds or directors’ and officers’ liability coverage.

It is the Committee’s impression that lack of appropriate statistical data corresponding to the more difficult-to-underwrite classes of insurance would appear to be a significant factor in the lack of availability of certain coverages. The statistics on loss experience collected by the Insurance Bureau of Canada under its Commercial Lines Statistical Plan are limited in scope and do not provide a sufficiently meaningful data base for effective ratemaking and participation in the more specialized commercial risk markets. Inadequate information about loss experience also results in a failure of insurers to identify market opportunities and fill in demand. As a result, profit opportunities are missed and gaps in availability occur.

D. PLACEMENT OF RISKS OFFSHORE

1. General Observations

When appropriate coverage is unavailable in the Canadian market either because of the nature of the risk or because the cost in Canada is considered to be unreasonable, commercial enterprises have access to international markets. Concern, however, arises that insurance placed offshore falls outside the supervision of the Superintendent. Companies might be better served by coverage in the Ontario market, where they are protected by the activities of the Superintendent. A further concern is that premium and other requirements on offshore placements may be influenced by factors external to this Province or to the Canadian risk environment.

That is, evaluation of the risk potential by offshore unlicensed insurers may be based on conditions in other jurisdictions that do not necessarily reflect the risk environment in this Province.

2. Current Volume of Business Placed Offshore

Any business, other than marine, placed with unlicensed insurers through brokers in Canada or placed in Canada through brokers outside the country, must be reported to the Federal Department of Insurance for the purpose of collection of a ten percent excise tax. The excise tax collected over a five year period is summarized below.

**EXCISE TAX COLLECTED ON
INSURANCE PLACED WITH UNLICENSED INSURERS
THROUGH BROKERS IN CANADA**

Fiscal Year End March 31	Amount of Excise Tax Collected (10% of Net Premiums Paid)
1973/74	\$301,400
1974/75	248,400
1975/76	357,000
1976/77	635,700
1977/78	944,500

Source: Department of Insurance, Ottawa.

The table above indicates a threefold growth over the 1973/74 to 1977/78 period in taxable insurance premiums paid to unlicensed insurers. This represents an annual average growth rate of 33 percent. There is therefore some evidence to indicate that an increasing volume of premiums is going offshore, especially for coverage related to large risk exposures.

Where the Federal Superintendent of Insurance is of the opinion that insurance is not available in Canada at reasonable cost, an application for exemption from the Excise Tax Act can be obtained. The amount of tax waived in 1977/78 is shown below.

**EXCISE TAX ON INSURANCE PLACED WITH
UNLICENSED INSURERS, 1977/78**

Excise Tax Collected	\$ 944,500	75%
Excise Tax Waived	332,188	25
Total	<u>\$1,266,688</u>	<u>100%</u>

The table above indicates that one-quarter of total insurance placed with unlicensed insurers qualifies for exemption from the excise tax. An estimated \$12.7 million in premiums were paid to unlicensed insurers for coverage on Canadian risks, about one-half of one percent of the \$2.5 billion direct premiums written in Canada in general, non-automobile, lines of insurance.

E. EFFORTS BY INSURERS AT FILLING IN GAPS IN AVAILABILITY

The industry continues to depend largely on *reinsurance* of commercial policies or portfolios at the individual company level to expand and utilize capacity. Availability in many commercial lines is therefore dependent on the efficient functioning of the reinsurance mechanism.

Various forms of risk-sharing among insurers have also mushroomed with the growth of insurable values and liability damages. The most common form of risk-sharing in use continues to be the *subscription policy*. Once used primarily in property coverages, it is now extended to liability coverages. In some cases, coverage is layered in order to insure the entire risk. Both subscription policies and layering depend on the effectiveness of the agent/broker in locating carriers who will subscribe or accept layers. The role of the agent/broker is critical in this method of ensuring availability.

Joint underwriting initiated by insurers is limited in application in the Ontario market to date. The primary example of this form of pooling is the organization of Canadian Industrial Risks Insurers (C.I.R.I.) which is organized to write risks in a specific market segment, namely that of highly protected,¹ large commercial risks. C.I.R.I. was organized more as a response to the success of the Factory Mutual companies in providing technical loss prevention expertise to this market segment, rather than for the primary purpose of increasing availability through risk-sharing.

Thirty stock insurance companies formed C.I.R.I. in 1973. Membership in C.I.R.I. affords many individual companies the opportunity to participate on risks they might otherwise have been incapable of underwriting as a result of the lack of individual capacity or lack of individual loss engineering and underwriting staff experienced in handling major property risks.

Each member of C.I.R.I. participates in covering a risk on a subscription policy basis wherein participation is established as a fixed percentage for each member and is identical for all risks. The Industrial Risks Insurers in the United States provide insurance for the portion not placed with the Canadian participants in the association. The original Canadian participation started at 28 percent and has grown only slowly to around 32-34 percent. Current Canadian premium volume is about \$20 million so that C.I.R.I. ranks among the top fifteen groups in Canada writing property and casualty insurance.

In contrast to the membership of the Factory Mutual organization, which is limited to the three insurers in the Factory Mutual System group,

1. Protected by automatic fire extinguishing devices where needed and backed by adequate public or private supplies of water.

C.I.R.I. provides the facility for a wide participation of Canadian insurers in a risk-sharing mechanism which emphasizes cooperation in loss reduction services.

There is a dilemma created in many lines of commercial insurance because the need for skilled underwriting resources appears to require concentration of market share among a few insurers who can then afford to build up the expert staff and resources needed to serve certain product line markets adequately. Clearly this tendency can be against the spirit of a competitive market and availability from a range of competing insurers.

The Insurers' Advisory Organization and the Association of Independent Insurers¹ have developed to *pool technical resources* while allowing members to compete for business. These organizations however concentrate their efforts on the more common types of coverages sold by multi-line insurers.

In sum, the industry depends on the reinsurance of commercial policies or portfolios at the individual company level, rather than on any collective, insurer-initiated approach to risk-sharing. The only insurer-organized mechanism is C.I.R.I. which is limited to a particular market segment. Many of the efforts at bringing together the commercial buyer with an insurer willing to take on his risks are dependent on the brokerage function to locate carriers who will subscribe on a policy or will accept layers of coverage.

The Committee in Part IV concerning Capacity, previously considered the requirements necessary to foster availability as follows:

- a regulatory environment that permits profits to be made and insurers to expand their financial capacity;
- attention by the industry to efficiency;
- attention toward building up greater technical expertise in the industry; encouragement of underwriters with special skills;
- risk-sharing among insurers;
- improved access of the insured to the insurer.

Many of these factors would appear to be particularly important in regard to commercial coverages where underwriting expertise and risk-sharing are essential to the placement of certain risks.

12.4 In view of the Committee's previous conclusions regarding the industry's responsibility for utilizing total capacity, the Committee once again in the context of commercial lines of insurance encourages the general insurance industry in:

1. The Association of Independent Insurers is a small group of insurers set up in May 1975 to handle rating and other matters relating to habitational property and automobile business. Members of this association are as follows: Canadian General Insurance Company, Gore Mutual Insurance Company, Saskatchewan Mutual Insurance Company, Waterloo Mutual Insurance Company, Wawanesa Mutual Insurance Company, Zurich Insurance Company, Canadian Indemnity Company and Economical Mutual Insurance Company.

- continued and better use of reinsurance;
- more use of formal arrangements for risk-sharing in the difficult-to-underwrite lines related to:
 - risks with high insurable values;
 - non-conventional risks, so that unpredictable losses are spread throughout the insurance system;
 - liability situations particularly with high exposures;
- better use of the brokerage function in bringing together insurers and customers;
- introduction of a commercial “insurance exchange” for hard-to-place and high exposure risks, so that underwriters with special skills are readily accessible. An exchange is preferable to formal risk-sharing arrangements because it maintains competition.

12.5 The insurance industry should endeavour to seek out the more efficient methods of risk-sharing and not be satisfied with approaches that perhaps rely too heavily on the agent or broker to locate sufficient numbers of subscribers for a risk placement.

Therefore, the Committee once again emphasizes its encouragement to the industry that it meet its responsibilities with respect to availability in all lines by a “take-all-comers” attitude on the part of individual insurers, supported by collective efforts at pooling risks which individual insurers are unable to keep on their own account.

If it becomes evident that the insurance industry is unwilling to take on a given risk or class of risks at an acceptable premium cost, government response can take one of two courses. The first response is discussion with the individual or business firm to determine the underlying causes of risk rejection by the insurance industry. The Committee recognizes that, through insurance, society has built up a “cocoon” of protection so that there is now the general expectation that all risks can be insured. In some cases this expectation denies the basic responsibility of insureds to take precautions against loss. For example, in the professional liability area, the appropriate response to lack of availability or high cost of coverage may be greater discipline and enforcement of a code of conduct in the profession unable to obtain coverage. Nevertheless, this need for loss control precautions among insureds does not absolve the insurance industry from its responsibility of endeavouring to insure even the high or substandard risks at a fair price.

The second response of government is to participate directly in the provision of the required insurance. Certain states in the United States have stepped into the insurance market to provide coverage when they perceived that a need for commercial coverage was not being met by the voluntary market. Specific examples include flu vaccine coverage and medical malpractice coverage.

However, the Committee does not consider as a viable alternative the

entry of government into individual “problem” areas of the insurance market. If the government is forced to take on the provision of insurance in several such “problem” areas, then serious consideration must be given to a full-line government-operated insurance mechanism for insuring the better risks as well as the poor risks.

12.6 While the alternative of government participation in ensuring availability of certain “problem” coverages is not unknown, the Committee does not propose this alternative for Ontario.

The Committee believes that insurance can be made available for all “insurable” risks at a price that reflects the extent of risk. If the price is prohibitive then transfer of the responsibility for insurance to the government or ultimately to the taxpayer is not a solution to the problem of price. It is merely a spreading of the price among all taxpayers, rather than among those with direct interest in the risk.

The Committee maintains that it is the responsibility of the general insurance industry to find a way of underwriting all risks to the greatest extent practical.

F. COST OF COMMERCIAL COVERAGES

1. Affordability in Commercial Lines

In many situations, affordability is not a paramount problem in regard to commercial coverages as the insured can usually engage in some form of risk management, such as:

(a) Loss Avoidance

The commercial enterprise may find it wise to avoid certain activities, such as the manufacture of certain products or the purchase of certain hazardous materials, because of the high risk associated with them. Similarly, it may avoid ownership of certain property if the risks involved are great relative to the advantages.

(b) Loss Prevention or Control

In most commercial lines of insurance, significant premium savings can be obtained if the chance of loss is reduced through safety programmes, building and equipment maintenance, fire alarm and control devices and so on. For larger commercial risks, inspection to detect hazards and reduce them is an integral part of insurance planning.

(c) Loss Retention

Retention of potential losses is a useful alternative to insurance for those losses which can easily be handled out of current income or out of

accumulated reserves. Retention of losses also provides a stronger motivation for loss control. When losses occur, payout is restricted to the actual cost of the loss at the time it happens. In contrast, under the alternative of insuring risks, losses are in a sense prepaid through premiums and the firm is required to contribute in its premiums to the overhead of the insurer as well as to expected claims costs.

With the assistance of the insurer, the broker or internal staff, the insured can often exercise some control over the hazards that influence his rate, perhaps achieve a hazard reduction and thus lower the premium cost. The reduction in premium is possible because a multiplicity of factors is taken into account in underwriting commercial risks, the factors varying depending on the category and complexity of the risk. In contrast, the personal lines buyer has virtually no flexibility in influencing his insurance cost through hazard reduction, because the rating system in personal lines does not account for specific factors of hazard.

Still, the cost of commercial coverages is not without public concern. The availability of insurance at reasonable cost to the commercial organization has an indirect impact on the general public. High commercial insurance costs or costly alternatives to insurance are likely to be passed on to consumers in the price of goods and services bought. The cost of commercial coverages also affects the business and service community in its investment and other risk-taking activities: a high cost of insurance that restricts risk-taking can result in an adverse effect on jobs and the economy.

2. Observations on Underwriting in Commercial Lines

In commercial *property* lines, underwriting information normally includes an inspection report on the property to be insured, indicating features which affect the potential for loss. Insurers belonging to the Insurers' Advisory Organization routinely use the reports produced by I.A.O.'s commercial property inspection service to obtain information on property features such as:

- occupancy or use;
- exposure to hazards on neighbouring premises;
- basic structural features;
- protection systems; and
- individual hazards such as faulty wiring, poor maintenance or overcrowded storage areas.

The above factors assist in defining a property as "protected" or "substandard" in terms of potential for loss. Substandard risks are rated higher on the basis of the inspection criteria.

In commercial *liability* lines, the risk factors considered in underwriting are less clearly defined. Often, the buyer of liability coverage is unaware

of what factors affect his cost. A similar complaint is evident in the *other lines* of commercial coverage: the insured typically has no understanding of the underwriting process and is seldom informed of what he can do to make his coverage more affordable to him or more attractive to insurers.

The Committee is concerned that the underwriting process in commercial lines of insurance requires substantial review and improvement. As in personal lines, the Committee finds that the data presently collected in the Commercial Lines Statistical Plan in regard to commercial line losses reflect rating criteria that were deemed appropriate when they were first established and once set have rarely been challenged. Likewise, the "schedule" rating process undertaken by the Insurers' Advisory Organization generally reflects long-established custom and tradition in the industry which may not be fully appropriate given current construction techniques and hazard conditions.

The Committee furthermore notes the relatively recent introduction of the Commercial Lines Statistical Plan and the industry's acknowledgement that considerable further development and improvement is required. The resulting lack of appropriate and meaningful statistical data in difficult-to-underwrite classes of insurance, such as many liability risks, is a matter of concern to the Committee as it has contributed to certain problems of price and availability described in this chapter.

Accordingly, the Committee points out the following areas for attention by the general insurance industry.

- 12.7 The Insurance Bureau of Canada's Commercial Lines Statistical Plan is the statistical data base currently utilized by the Insurers' Advisory Organization and many individual insurers in their ratemaking. The Commercial Lines Statistical Plan is not sufficiently detailed or comprehensive to provide the most meaningful basis for objective rate-making. This concern is widely recognized by the insurance industry.

In general, the Committee encourages the industry to devote more attention on an immediate basis to the improvement of the Commercial Lines Statistical Plan and to the collection of more meaningful loss information in all lines of commercial coverage. Furthermore, the Committee urges all insurers to participate in responding to the I.B.C. Commercial Lines statistical reporting system, as demonstration of industry-wide commitment to developing an appropriate, cost-effective data base that will assist in the better pricing of the commercial insurance product.

- 12.8 It has been suggested that the "schedule" ratemaking process used for many commercial property risks is arbitrary and outdated, with insufficient credit or debit being given to loss reduction measures, new construction features and newly identified hazard factors. The Committee

wishes to encourage the industry and the Insurers' Advisory Organization in particular to review and develop improved methods of rating commercial property risks.

- 12.9 Of particular concern to the Committee is the influence of loss experience in other jurisdictions on the cost of certain liability coverages in this Province which are necessary to protect third parties. The Committee believes that this problem can be resolved through more comprehensive and detailed statistical information on the liability loss experience in this Province.

The Committee believes that a collective approach toward data gathering is particularly required in regard to liability risks in order to ensure that the information compiled is a reliable reflection of the Ontario risk environment.

PART VI
COMMUNICATIONS

CHAPTER 13

Communications

A. THE RESPONSIBILITY FOR COMMUNICATIONS

1. Introduction

Throughout its hearings, the Committee has encountered continual reference to problems of communication between the general insurance industry and the consumer, and among the various participants in the industry. Witnesses before the Committee, representing both individual consumers and business organizations, have established by their comments and submissions that there is a basic lack of understanding of the insurance process among most consumers.

The Committee is most concerned about communications in the general insurance industry because it sees a need for more advice and counselling with respect to the insurance purchase than with respect to the purchase of most other products. While the insurance product is essential to consumers in most instances, it is intangible and hence is perceived by many consumers as being complicated. The resulting greater need for advice and counselling demands a high standard of communication between the insurance industry and the consumer, be he a personal lines buyer or a commercial lines buyer. Accordingly, the Committee devotes this Part of the Report to its observations pertaining to the topic of communications.

2. The Role of Communications

The insurance industry has long recognized the need for providing both information and advice to the purchasers of the insurance product, for the evident reason that the insurance product by its nature requires explanation. It is the Committee's impression that the insurance industry has in the past concentrated more on providing the consumer with advice than with information. Insurance companies in this Province have, for the most part, relied on local agents to advise customers in the purchase of the coverage best suited to their needs. Less emphasis appears to have traditionally been placed on educating the customer.

Recently, industry representatives have admitted publicly that more can be done with regard to public information and have resolved to devote more attention to the matter of communication:

"There is a heavy onus for consumer education on the industry; both the companies and the agents that deal with the public must work day and night to develop an effective communications program"¹

1. *Globe and Mail*, "Outside industry man new insurance chief", September 15, 1979. Remarks by John Lyndon, President, Insurance Bureau of Canada.

The Committee strongly endorses the industry's efforts to improve communications. These efforts must be directed both to the consumer who relies on the sales intermediary or insurer to choose coverage for him and to the consumer who wants to be informed so that he can *buy* his coverage based on knowledge and comparative shopping.

Communication is of heightened importance today because many consumers no longer appear to be satisfied to accept passively the first product offered by an insurer or agent. The greater value of assets to be insured and an uncertain risk environment that increases premium costs would appear to encourage the personal lines and the commercial lines insurance buyer to be more selective in his purchase. The traditional reliance on advice may today be replaced with a greater expectation for information. Both are essential in the Committee's opinion.

While recognizing that there must be an onus on the consumer to know what he is buying, the consumer cannot be expected to seek out all the information he needs to make an informed insurance purchase. As in all industries marketing consumer products, there is also a responsibility on the insurance industry to provide the consumer with at least a minimum of information concerning the insurance process. In the insurance industry, the responsibility to inform would encompass:

- the insurance product and hence an explanation of the coverages available;
- the services provided by the insurer as matters of non-price competition; and
- the premium price and an explanation of how cost is arrived at, to the extent that the consumer has influence over some of the factors that determine price.

The Committee maintains that the present consumer environment requires that the insurance industry provide a better quality of information in regard to the above matters than has been provided in the past.

In greater detail, it would appear that the following requirements make up the consumer's needs for advice and information:

- assistance in determining protection needs;
- assistance in matching protection needs to available coverage;
- information regarding ways to control loss, particularly if loss reduction is associated with lower premiums;
- information regarding the advisability of retaining risks through deductibles or other forms of self-insurance;
- information to determine the quality, reliability and suitability of *competing* products and to evaluate price differences;
- information on matters of claims service, regarding claims notification procedures, the adjusting process and arbitration procedures; and

- ready access to someone who will answer questions objectively and will resolve complaints as they arise.

On the other side, the Committee also sees a vital need for the insurance industry to understand the consumer and the risk environment. A combination of information is required, gathered through industry-wide statistical plans for reporting loss experience data, through consumer information services, through direct surveys of consumers, the economy and individual industries and through industry personnel familiar with their customers. A flow of information to the insurer is necessary to provide a basis for evaluating the nature of risks affecting consumers for purposes of developing appropriate coverages, for more accurate loss prediction and for ensuring availability in *all* areas of market demand.

- 13.1 The Committee sees a vital need for an effective two-way channel of communication between the public at large and the insurance industry. There is today a growing demand among many consumers to learn more about the products they are purchasing. On the other side, there is the need for an informed insurance industry which will be responsive to the consumer's protection and service needs. The responsibility for developing an effective two-way communications process within the insurance system falls on the industry.

3. Government Involvement

Better communication in the insurance industry can be encouraged in three ways. First the insurance industry can be urged to place a greater degree of emphasis on communication through the cooperation of insurers, agents, brokers, adjusters and others in establishing various programmes that will inform Ontario policyholders. In fact the industry already realizes that it must do more with regard to communication, as confirmed by the new President of the Insurance Bureau of Canada in a recent address: "in a time of reawakened consumerism . . . the insurance industry . . . simply has to become a better communicator."¹

However, despite the best intentions of the industry, it is difficult to be assured of the effectiveness of industry efforts in communicating on a very basic level—between the individual insured and the agent or adjuster. Therefore, a second way of encouraging better communications at this level could be provided through the development of some mandatory tangible proof that a process of communication has taken place. At the time of sale, proof of communication could take the form of a completed application form.

Finally, of invaluable assistance in improving communication are measures which would simplify or perhaps standardize the product and the transaction process. The responsibility to simplify or standardize the product

1. Address by Mr. Jack Lyndon, President of the Insurance Bureau of Canada, to the 1978 Annual Convention of the Independent Agents of Alberta.

could be left with the industry or could be imposed by government in order to guarantee a uniformity and universality of approach.

The objective of the Committee as expressed in the guidelines set out in Part III is to minimize government regulation. Therefore, the Committee believes that the responsibility for improving communications should rest in the hands of the industry. Improvement of communications at the agent broker level, development of better application forms, simplification of policy wordings and other measures toward improved communication should be achieved at the initiative of industry participants.

Nevertheless, the Committee believes that the government should maintain an overseeing role to ensure that the industry is assuming an active part in educating the public for the intelligent purchase of an essential product in a competitive market place. Without imposing a burden on the industry and without direct involvement in industry operations, the government cannot effectively supervise day-to-day communications activities between the individual insured and the agent or adjuster.

The government must nevertheless be assured by the general insurance industry that it is taking a "communicative" attitude toward serving the insurance market. The industry must also demonstrate that this attitude is widespread and not limited to a segment of consumer-conscious industry participants. The Committee expects that the general insurance industry as a whole will act, in the future, to develop appropriate means of better informing, educating and advising the consumer. At the same time, the Committee takes the opportunity in this Part of the Report to make comments on a number of specific matters pertaining to communications that have come to its attention. These matters include:

- "plain language" communications,
- the standard policy,
- the application form as evidence of communication,
- a consumer information service,
- insurance incidental to other purchases, and
- the role of the Superintendent to inform.

B. "PLAIN LANGUAGE" COMMUNICATIONS

When a consumer purchases an insurance product in property and casualty lines, he may examine thoroughly the terms, conditions and other detailed wording of the insurance policy to assure himself that he will receive the protection he expects for payment of his premium. However, few insurance buyers are knowledgeable enough about insurance matters to understand the contract terms in the policy sufficiently well to judge the value of the product they are buying. They are furthermore at a disadvantage because they are unable to test out the product in any way short of experiencing a claim.

These problems appear to be encountered especially by personal lines buyers but are equally apparent in the case of commercial coverage buyers, where, for example, the boiler and machinery insurance contract was specifically cited as difficult to interpret by representatives of the Ontario Risk and Insurance Management Society. In general, at the end of its public hearings, the Committee is left with the overall impression that the insurance policy or contract is too complicated, in virtually all lines of general insurance.

13.2 The Committee believes the insurance industry must be sensitive to consumer needs for a simplified policy. Wherever practical, the Committee recommends that the industry rewrite policy contracts in personal lines, in automobile lines, and in commercial lines of insurance to simplify their wording and format. In the case of the standard automobile policy, the industry would be required to cooperate with the Superintendent in the re-writing of the policy so that changes can be incorporated in The Insurance Act. The Committee previously made this recommendation in the First Report.¹

The Committee sees three further alternatives available for resolving the consumer's difficulty in understanding the insurance contract:

- introduction of a "plain language" application form;
- translation of the insurance contract into "plain language"; and
- substitution, for the contract itself, of a "plain language" brochure explaining the policy.

13.3 The Committee recommends that the re-writing of property and casualty policies be directed toward converting each policy to as simple and understandable a language as possible—that is, into "plain language". The industry should devote immediate attention to the re-drafting of its personal lines policies and to the redrafting of the standard automobile policy as recommended in the First Report.² "Plain language" policies should be made available to policyholders in Ontario in both English and French.

The Committee recognizes the difficulty of determining the utility of the contract, as presently written or even in "plain language", in the hands of the average personal or commercial lines policyholder. While, in fact, the policyholder may be uninterested in reading the details of his coverage at the time of purchase, he may wish to refer to the contract if he experiences a loss. Without the contract, the insured does not have a full record of his coverage.

There is no legislated requirement for an insurer to deliver to the policyholder a copy of a fire policy or any other non-automobile general insur-

1. *First Report on Automobile Insurance*, page 40.

2. *First Report on Automobile Insurance*, page 40.

ance policy.¹ In practice, most insurers provide their policyholders with a copy of the policy, although there are exceptions, primarily in personal lines where some insurers substitute an explanatory pamphlet or other written proof of insurance purchase. The group merchandising plans which have come to the Committee's attention likewise do not issue individual policy contracts but maintain a master policy which is accessible to group members on request.

13.4 To satisfy the consumer's need to know about the insurance product, the Committee recommends that each policyholder be issued a copy of his policy on the first issuance of the policy and with every addition or deletion to his policy. The mere act of renewing should not necessitate the delivery of a further copy of the policy. The Committee recommends that delivery of the insurance policy to each insured be made mandatory in all lines of property and casualty insurance.

The additional cost involved in delivery of the policy would be minimal, in the Committee's opinion, in comparison to the informational value of a redrafted, readily readable policy in the hands of the consumer. The practice of substituting certificates of policies should be dispensed with, except as an additional record to the policy itself.

13.5 The Committee sees a need for further "plain language" communication through brief, illustrative and simply worded pamphlets or brochures which supplement the policy contract. The Committee urges insurers not to be satisfied that they have fulfilled their responsibility to inform simply by issuing the contract—especially in the personal lines of insurance.

The Committee recommends that a supplementary brochure be issued at the time of each renewal or change in the terms of the policy and that, at a minimum, it provide the insured with the following information:

- a brief description or illustration of the details of the coverage being provided by the policy;
- the dollar or other applicable limits applied to the coverage or components of the coverage, including the provisions for deductibles;
- the basis of recovery, as actual cash value or replacement cost value or other, with an illustrative example;
- the list of subscribing insurers and their share of the risk in the case of a subscription policy;
- who to contact in the insurer's organization or in the agency office in regard to questions, complaints or claims;
- other necessary information, some of which will be indicated by the Committee later in this Report.

1. Supra, page 91.

C. THE STANDARD POLICY

A standard product simplifies the consumer's needs for information and communication in the purchase process. At present there is a lack of homogeneity among insurance products. The Committee discussed the need for a standard coverage in Chapter 10 in regard to the consumer's coverage expectations and his desire to price shop. Clearly a standard policy for personal lines coverages and for many commercial coverages would simplify the purchase decision for consumers.

In considering further the implementation of a standard policy, the Committee concluded that, in respect to residential lines of insurance, an intermediate approach to standardization would benefit the consumer while still permitting flexibility and innovation on the part of the insurer. The Committee reinforces in this chapter its previous encouragement to the industry to develop and market a standard *core* coverage for residential risks. The concept of a standard core coverage will enable consumers to make price and product comparisons which are one of the goals of effective communication in the insurance system.

13.6 The Committee also encourages the insurance industry to develop and use a simplified, standardized format for its personal lines policies, wherein elements that are common throughout the industry are grouped in similar order or page sequence in the policies drawn up by individual insurers. A standardized format will assist consumers in identifying readily those elements that are common in all policies and those that differ by company or by policy. A similar standardization of format should be considered for commercial line contracts where possible.

D. THE APPLICATION FORM

The exchange of underwriting information during the application process provides an opportunity for communication between the sales intermediary and the customer. The completed application form is therefore, in a sense, proof that communication has taken place.

Despite the excellent opportunity for communication presented in the preparation of application forms, the Committee found that the sellers of insurance are frequently casual and inaccurate in completing these forms with their customers. In fact the Committee discovered that considerable time is spent by insurers in reviewing and correcting the application forms received from their agents.

The Committee sees a number of advantages to a properly designed and administered application form which is then delivered to the consumer:

1. The application form can serve as a vehicle for communication of coverage options, indicating in a "plain language" format the choice of cover-

ages, deductibles or packages available to correspond to the consumer's needs. During the application process the insurance buyer should be made aware of all coverage options available to him and could be required to check off those he chooses to carry.

2. The application form can assist the buyer in understanding the criteria used in underwriting and the way in which rates are determined. In class-rated lines, the form could show the insured in clear terms the precise factors that have been taken into account in determining the class to which he has been assigned for rate calculation purposes and the rate applicable to that class under the insurer's rate manual. In "schedule" rated lines, the form could list the factors which increase the rate to be charged and those which decrease the rate.
3. The application form can assist the buyer in product and price comparisons, if structured to provide a quote for a standard policy or a *core* component as recommended by the Committee in Chapter 10 of this Report.
4. The application form can serve as a "plain language" record of the consumer's purchase decision, setting out the representations that have been made, on the basis of which the insurer decides whether to accept the application and on which he bases the calculation of the applicant's premium.
5. The application form can serve as an additional means of informing the consumer regarding where enquiries and complaints can be directed as well as providing other general information.

The application form, as a proof of communication, will only be of value in the communications process if it accomplishes more than a recording of information. The consumer's awareness of the significance of the information he has communicated may only be established fully if a copy of the completed application form including premium calculations is sent to the consumer to examine.

- 13.7 The Committee recommends that the application forms in property and casualty lines be revised substantially into a form that assists in informing the consumer as well as assisting the insurer in obtaining underwriting information. The Committee encourages the general insurance industry to develop the application form as a communications tool, designed to assist the consumer in recognizing the coverage options available to him and in choosing among those options.

Universal *standard application forms* are receiving attention as means of introducing consistency and savings into the insurance underwriting process. Development of standard application forms for automobile and for personal residential lines has been undertaken in this Province by the association of Independent Insurance Agents and Brokers of Ontario on behalf of its members. In the United States, uniform applications for the commercial

lines of general liability, business automobile and commercial property are expected to be implemented by agents in most states starting in January 1979. Sales intermediaries therefore appear to be willing to make use of standard application forms, mainly for administrative and transaction processing purposes. However, the redesigning of the forms primarily to assist in structuring communication with the client and to permit price and product comparisons, has yet to be undertaken.

In addition to the application processing advantages of standard forms, standardization of the application process requires that underwriting information concerning the applicant and the risk be collected on a uniform, consistent basis corresponding to the needs of an acceptable risk classification system. This aspect of application form standardization corresponds to the Committee's criteria of objectivity and clarity in the classification system and in the collection of underwriting information. A further advantage of standardization is the ability provided to the consumer to take the application form to different insurers or different agents to obtain an offer of insurance and a quote for the premium, based on a standard set of rate characteristics.

- 13.8 The Committee encourages the general insurance industry to develop and implement *standard* application forms in the personal lines of insurance and, where practical, for commercial lines and especially for those coverages applicable to small commercial risks. As well as a communications tool, the standard application form should also be designed as a means of collecting underwriting information on a uniform, consistent basis corresponding in each line of insurance to a risk classification system applied uniformly by all insurers marketing that line of insurance.
- 13.9 A full or abridged version of the application form should be delivered to the policyholder at the time of each renewal of the policy, requesting the policyholder to check off any change in his choice of coverage and verify the information on the form. No reply from the policyholder could be taken as an indication of no change desired in the coverage.

E. A CONSUMER INFORMATION SERVICE

A vital link in the communications structure of the general insurance industry should be a consumer information service to which the consumer can turn when he has a question or problem and through which he can readily access the person who can best help him. Several insurers have recognized the need for a consumer information service and have set up a customer enquiry department to handle queries and complaints. One insurer has recently established this service on a twenty-four hour, "hot-line" basis, accessible to all policyholders across Canada.

The Committee expects that such a service also provides the insurance

company with an excellent mechanism for learning from the customer as well as communicating to him. A consumer information service can provide the insurer with valuable information on the types of problems that insureds experience. This information likely can be used to suggest ways in which the insurer can compete by offering a better product or service than that of his competitors.

While the Office of the Superintendent also provides a service for answering consumer questions and complaints as do the Independent Agents and Brokers of Ontario and other consumer groups,¹ there is no central well-publicized focal point for such matters. A coordinated industry effort regarding the handling of consumer enquiries and complaints has several advantages. In the first place it can provide an enquiry and problem-solving service as well as a complaint handling service to those policyholders not fortunate enough to be insured with a company that emphasizes such services to its customers. It can also act as a convenient facility for redirecting questions to the appropriate insurers, agents or adjusters best able to assist the consumer. In addition it resolves the difficulty of those persons who do not contact their own insurer because they fear that the resolution of their problem may result in a premium increase. A coordinated complaint-handling and informational service can serve another purpose. It provides a collective industry mechanism for recording and analyzing consumer needs for information and consumer complaints regarding the insurance industry. Further it entrusts the responsibility for complaint resolution to the industry rather than to the Office of the Superintendent of Insurance. The activity of the Office of the Superintendent in handling consumer enquiries and complaints is in some part the result of the consumer being unable "to get a straight answer" from either the insurer, agent or adjuster within the insurance industry.

Complaints, and the public's perception that it is not being treated fairly by insurance companies, reflect frustration by the general public caused by lack of information. To relieve this frustration in some part, it would appear to be in the self-interest of the insurance industry as a whole to cooperate in establishing and promoting a convenient, dependable facility that answers consumer's questions and assists in problem-solving. As noted, the utility of a consumer information service is already recognized by certain insurers and associations in the industry. However, the potential benefits of a coordinated recording of consumer requests for assistance are not fully realized through a fragmented approach to the concept of a consumer information service.

13.10 The Committee believes there is a need within the general insurance industry for a focal consumer information and complaint service that is accessible to all Ontario residents and businesses and is well-publi-

1. Supra, page 57.

cized so that every insurance consumer is aware of its existence. The Committee recommends the establishment of this service in the Province of Ontario.

- 13.11 The Committee further recommends that the costs of this service be borne by the general insurance industry and that the service be operated by the industry. In order to capture the cooperation of direct writers in this service, this consumer information service would best be established under the auspices of the Insurance Bureau of Canada.
- 13.12 The consumer information service could be linked with a province-wide risk placement service for personal lines as encouraged by the Committee in Chapter 9.
- 13.13 Access to the consumer information service should be free and should be well-publicized throughout the Province. A telephone number providing access should be included on all application forms and on all explanatory brochures accompanying policies.
- 13.14 The Superintendent should exercise a supervisory role in regard to the industry-wide consumer information service. His foremost concern would be to ensure support by all insurers and by agents, brokers, adjusters and other industry groups to the extent deemed necessary.
- 13.15 The operation of the consumer information service should be tied in with the need for the Superintendent to be informed on a regular basis, either monthly, quarterly or annually, of complaints or problems experienced with individual insurers, agents or adjusters. As a result, the Superintendent can investigate and take appropriate action regarding activities against the public interest. Certain matters of information could also be taken into account by the Superintendent in his role of monitoring of the industry.
- 13.16 Enquiries and complaints to the consumer information service should be recorded and analyzed as a means of identifying areas for industry improvement in performance and in communication. The Superintendent as part of his supervisory activity, should be required to issue annually a brief report containing the statistics derived from analyses of the enquiries and complaints to the consumer information service.
- 13.17 In regard to the public reporting of complaint matters by the Superintendent, the Committee intends that the Superintendent would not only publish information on the types of complaints that arise against the insurance industry, but also that he would publish the names of individual insurers, agents, brokers, adjusters and so on with over ten complaints in a reporting year period.

In so doing, the Superintendent should investigate at least some portion of the complaints recorded by the industry-operated consumer information service or otherwise directed to his Office, to determine which are legitimate, not necessarily in terms of an illegal act, but also in terms of inconvenience or frustration to the consumer. In these investigations, the insurance industry will have been given the opportunity to refute complaints. Those still apparent as legitimate complaints should form part of the Superintendent's regular reports. Any rough justice to individual industry participants should be made up by the increased efforts of the industry to reduce complaints. Accordingly, publication of complaints will serve the public interest.

F. INSURANCE INCIDENTAL TO OTHER PURCHASES

The Committee notes that the consumer, in the purchase of insurance which is incidental to other purchases, may not be provided with sufficient information or an opportunity to choose among the various types of coverages available to him. Familiar examples of insurance incidental to other purchases include contact lens insurance and flight or other travel insurance.

In most cases, insurance sold as incidental to the purchase of a good or service may not be sold, and likely need not be sold, directly to the customer by a licenced agent or broker. However, in some cases, the consumer may feel obliged to buy related insurance from the person selling the principal good or service or may accept an insurance product not suited to his needs.

13.18 The Committee sees an informational requirement related to the purchase of insurance incidental to other purchases:

- That the cost of insurance be separated from the cost of the other goods and services bought and be so identified clearly; and
- That the consumer be made aware in a clear, written format that he has the option of purchasing or not purchasing insurance from a source other than the seller of a good or service.

The Committee recommends that the Superintendent ensure that all licenced insurers offering insurance products through the sellers of other goods and services be made responsible for making certain that their products are sold in accordance with the above informational requirements.

G. ROLE OF THE SUPERINTENDENT TO INFORM

13.19 The Committee recommends that the Superintendent take on a more active communications and reporting role towards the insuring public.

The Committee is anxious to see the Superintendent assume a more aggressive posture in this regard while at the same time developing the details of his role in the monitoring of competition as recommended in Part III of this Report. In this context, the Superintendent should engage in the analyses and reporting of complaints directed to the consumer information service as recommended earlier in this Part of the Report. From time to time, in response to identified problems in the insurance industry, the Superintendent should also investigate and prepare public reports dealing with specific problem areas.

The Committee is concerned that the ability of the Superintendent under Section 18 of The Insurance Act to “publish from time to time notices, reports, correspondence, results of hearings, decisions and any other matters considered by the Superintendent to be in the public interest”, may be impaired by the provisions of Section 90 of the Act regarding privileged information.¹

While Section 18 provides the Superintendent with powers of publication, Section 90 appears to override Section 18 in so far as the two provisions conflict, based on the principle that reports made by citizens to government officials under compulsion of law should be privileged. A legal opinion² addressed to the Committee noted that there is nothing in the Act which gives any indication as to the meaning of these sections so that it is not entirely clear whether, in fact, the two provisions conflict since they seem to refer to different types of information.

13.20 The Committee recommends to the Minister that, as a minimum, Section 90 of The Insurance Act be amended as appropriate to permit the Superintendent to request information and publish reports pertaining to the monitoring of the effectiveness of competition and to the matter of public disclosure of complaint statistics.

1. *Supra*, page 81.

2. Refer to Appendix K to this Report.

PART VII

QUALIFICATIONS AND CONDUCT

The Committee's objective in the general insurance industry is a better satisfied consumer and a better level of service in the industry. Previous Parts of this Report examined capacity, availability, coverage and cost as the main outputs of the insurance industry. Quality in the service accompanying these outputs and, as a separate consideration, quality in communication are more likely to result with the application of *standards* of qualification and conduct. In this Part of the Report the Committee examines the topics of qualifications and conduct in their relationship to the quality of service to be expected from the general insurance industry.

It is the Committee's view that these topics are of major importance in the general insurance industry. Most consumers need the protection of insurance but do not understand the insurance process. They have difficulty in judging the quality of service they receive, largely because the product they buy is intangible at the time of purchase. They rely therefore on the general insurance industry to advise and inform them in a competent, conscientious manner. The consumer's confidence in the industry's ability to advise and inform is affirmed by the assurance that standards of qualification and conduct govern industry representatives.

The interest of the government in the need for well qualified persons in the insurance industry, who conduct their business in a responsible manner, has long been established in The Insurance Act. The Superintendent's power to grant, revoke or renew licences is the basis for government regulation of the qualification standards, sponsorship standards, financial standards and conduct of insurance companies, agents, brokers and adjusters. The two chapters in this part examine the government interest in regard to qualifications and conduct respectively.

CHAPTER 14

Qualifications in the General Insurance Industry

A. QUALIFICATIONS AND COMPETENCE

Qualification standards for participation in the general insurance industry are intended to demonstrate to the consumer that certain educational and training requirements have been met by industry personnel as a probable indicator of competence in future performance.

The Committee regards competence to be essential in the general insurance industry for two reasons:

- to serve the consumer well, and
- to manage the insurance industry most efficiently.

Service to the consumer takes into account the interests of the individual consumer and his treatment by the insurer. Management of the industry concerns the overall efficiency of the insurance system in this Province and its ability to meet the expectations of the public. The qualifications of the people dealing directly with the consumer and of those managing the industry are the subject of this chapter, under the headings of:

- qualifications at the insurance company level;
- qualifications of agents and brokers;
- qualifications of adjusters; and
- qualifications of others associated with the insurance process.

- 14.1 In general, it is the Committee's observation that an insurance industry which devotes greater attention on a voluntary basis to the improvement of qualifications will more readily demonstrate competence and will meet the Committee's objectives of a better satisfied consumer and a better level of service. The Committee generally encourages the general insurance industry to do much more in educating and training its personnel.

B. QUALIFICATIONS AT THE INSURANCE COMPANY LEVEL

1. Responsibility for Qualifications

The general insurance industry, if it is managed well and operated efficiently, will ensure that the consumer need not look for risk protection outside the insurance system or outside the industry in this Province. On the other hand, lack of qualified managers, underwriters and employees in the industry will ultimately reflect in poor performance, inefficiencies and high costs so that the consumer will seek protection alternatives outside the Ontario insurance system supervised by the Superintendent.

At the present time, insurance companies take on a responsibility for

the qualification of persons in the industry but in varying degrees depending on whether the persons are employees, are bound through an agency agreement or are hired on a fee for service basis. It appears to the Committee that little is done in practice by insurers to monitor the activities and qualifications of persons who are not direct employees of the insurance company. However, many insurers do exercise some discretion in dealing with outside sales or adjuster intermediaries by reviewing their qualifications to service the consumer. In addition, the insurer is likely to cancel agreements or services if persistent problems arise.

In the case of persons employed by the insurance company, the insurer has a responsibility for the qualifications and performance of these persons to a number of interested parties, including the Superintendent, owners and policyholders, the industry as a whole and the public at large. In the case of the Superintendent, his authority over licencing of insurance companies extends his interest to the various employees of the licenced company. If the employees are poorly qualified, this factor may reflect in the company's inability to fulfil its various responsibilities under the licence in an efficient manner. In regard to owners and policyholders, the insurer must ensure that incompetent personnel do not lead to loss of competitive position and perhaps to business failure. Members of the Insurance Bureau of Canada, in fulfilling their responsibilities to other insurers as a collective body, must meet the objectives of that organization for a high standard of services and economies to the insured public. Finally in regard to the public at large, those persons who manage and provide technical services to the insurance industry should be well qualified in order to ensure the widespread availability at a reasonable cost, of an essential product.

2. Current Practices Regarding Qualifications

There are no mandatory qualification requirements applied to those persons directly employed by insurance companies, including those employed as sales persons. The efforts of insurance companies in improving qualification standards among their own personnel are channelled mainly through in-house training and education programmes and through encouragement of staff to participate in the courses given by the Insurance Institute of Ontario. Emphasis on in-house programmes differs by company but is normally related to training in general insurance matters, insurance related systems and procedures, supervisory skills and skills in functional and technical areas such as underwriting, processing systems and claims examining.

The Committee had the opportunity during its hearings to learn about the Insurance Institute of Ontario, which is devoted solely to educational programmes on an industry-wide basis. The national Institute, with which the provincial Institute is associated, was formed to establish a uniform standard of insurance education and examinations across the country. The na-

tional institute sets a programme of subjects, conducts correspondence courses and evening classes in community colleges and universities and sets and marks examinations leading to the designations of Associate of the Insurance Institute of Canada (A.I.I.C.) and Fellow of the Insurance Institute of Canada (F.I.I.C.). It also offers a General Insurance Essentials programme for those employed by the industry in clerical functions and those who may be new to the insurance business or who have not undertaken any previous insurance education. Specialty courses and seminar programmes are also an important part of the I.I.C. activity.

Participation in I.I.C. courses is voluntary or can be subject to encouragement by the employer. The I.I.C. indicates that it has a membership of about twenty percent of the workforce in the general insurance industry in Canada. Members are included from all sectors of the industry.

The Committee considers as most worthwhile the efforts of the Insurance Institute of Ontario and the national Institute in developing and administering educational programmes related to the business of insurance. Greater participation in these programmes by all sectors of the general insurance industry should have a favourable effect on the quality of service provided in the industry.

3. Future Emphasis on Education

In seeking to encourage the general insurance industry to do more to educate and train its personnel, the Committee makes the following recommendations:

- 14.2 Greater support should be given to the activities of the Insurance Institute of Ontario by insurance companies and by agents, brokers and adjusters. At the least, this support should take the form of greater encouragement to employees and to fellow participants in the industry to take part in the formal courses, seminar programmes and specialty courses of the Institute. In particular those employees in contact with the public should be encouraged strongly to take part in educational programmes.
- 14.3 The Insurance Institute of Ontario is to be encouraged in its updating of course materials, in its programme of specialty courses and seminars and in its expansion of programmes in local communities. The facilities of the Insurance Institute of Ontario might also be considered for purposes of consumer education and for the qualification of agents, brokers and adjusters as outlined later in this chapter.
- 14.4 Insurance companies are urged to undertake formal training programmes and other educational initiatives, such as seminars and writ-

ten materials, directed both at internal personnel and at outside agents and adjusters to acquaint them with improved systems and procedures in underwriting, policy processing and claims handling and to update their knowledge in the areas of insurance policy changes and changes in government policy and regulations.

- 14.5 The Committee repeats its conclusion in Chapter 8 regarding the need for the recruitment, hiring and training of qualified underwriters familiar with the local risk environment and the protection expectations of consumers. The industry in Ontario should also undertake to educate and train personnel wherever there is a lack of qualified staff at any level. Appropriate educational and training programmes should be developed in all areas of industry operation.

C. QUALIFICATIONS OF AGENTS AND BROKERS

1. Present Qualification Requirements

The Committee's objectives in considering qualifications, are a more satisfied consumer and a better level of service in the general insurance industry. The government has a role to play in regard to the activities of agents and brokers in meeting these objectives. Yet the business of government is not to *guarantee* that the consumer is satisfied by the service of agents and brokers: there is in fact no method of guaranteeing that the consumer will always be satisfied.

At the present time, in the general insurance industry, the government through the Office of the Superintendent establishes a series of conditions for agents and brokers who sell the insurance product in this Province. As evidence that the Superintendent is satisfied that these conditions have been met, a licence is granted to an agent or broker.

As one of the conditions for the licence of an agent, an individual must pass a qualification examination administered or approved by the Office of the Superintendent. In practice, agents' qualifying examinations are set either by the Independent Insurance Agents and Brokers of Ontario or by the Superintendent. A sponsorship condition is also applied in the licencing of agents. Applicants to become a licenced agent must provide proof of appointment by a licenced insurer to solicit business on its behalf. Beyond the initial examination and sponsorship requirements, there are no further mandatory qualification requirements for agents, such as in-service training or continual education requirements. The initial examination condition for licencing is considered by many in the industry to be a minimal requirement in terms of the knowledge and skills tested.

There is no qualifying examination requirement to become a licenced broker. There are neither qualifying nor licence requirements for staff sales persons or for insurance consultants. Rather than submitting to examination and sponsorship requirements, brokers' applications for licencing must show available capital, skills of the individual, reputation and competence as recognized by the statement of at least three reputable persons resident in Ontario.

2. Observations on Licencing and Qualifications

The Committee does not regard the licencing of an agent or broker as an assurance that the consumer will be well served; nor does it regard the accompanying qualification standard for agents as evidence of competence in performance. However, the Committee is concerned that the consumer on his part may well perceive the licence as an assurance of competence.

In any event, the licencing requirement is necessary to establish the Superintendent's authority over agents and brokers, particularly in terms of their handling of premium funds. Likewise, the qualification requirement as a condition of licence is of value even at a minimal level: at the least it establishes that the sales intermediary serving the consumer has some knowledge about the insurance product and system he promotes. The Committee, however, believes that a relatively high standard of qualification is more likely to result in a quality of service tailored to individual consumer needs than a minimal level of knowledge. The latter may nevertheless be sufficient for those tasks of the agent or broker regarded as mainly administrative or related to the processing of application and claim forms.

The Committee furthermore believes that the same qualification standards should be applied to both agents and brokers; that is, brokers should not be exempt from meeting the educational or examination requirements applied to agents. It is also the Committee's view that the consumer expects the same level of competence from everyone he deals with, whether an "independent" agent, exclusive agent or salaried salesperson.

The Committee believes that a qualification requirement is most essential in regard to those sales persons who deal with more than one insurer, or who are "proprietors" in the sense that they regard the clients they deal with as their own book of business rather than that of the insurer. In such cases, the insurer likely has less influence on the qualifications and conduct of the sales intermediary and less interest in training or educating him since he may also solicit business for other companies.

As a final observation, the Committee does not wish to see the entry of

new agents or brokers into the general insurance field reduced by the application of too stringent qualification standards. In many instances specialized knowledge or skill is not required by the agent in his day-to-day duties. Furthermore, competence is an objective reached through continual learning on the job and experience in dealing with consumers; it is evident that neither lax nor stringent qualification standards can accomplish this objective alone. The Committee therefore emphasizes the role of continuing learning in the efforts of agents and brokers to satisfy consumer needs and meet peer group objectives.

Given these considerations, the Committee's specific recommendations follow.

- 14.6 The Committee concludes that the essential nature of the protection insurance offers and the duty of care placed upon the agent and broker in advising his client on his protection needs necessitates a higher standard of qualifications to be set for agents and brokers than applied at present as a licencing condition.
- 14.7 The Committee also concludes that the same educational or examination qualification requirements be applied to both agents and brokers.
- 14.8 The Committee reaffirms its conclusion in the First Report that the activities of those sales persons employed by an insurance company are supervised adequately by the Superintendent's broad authority over the licenced insurance company. Accordingly it is the responsibility of the insurance companies to set internally a standard of qualification and competence for these persons commensurate with their duties and, at the least, equivalent to that imposed on outside sales intermediaries performing similar tasks.

The Committee regards sales persons as employees of an insurer if they are paid directly by salary or are on a commission basis but with the book of policyholder business designated as the property of the insurer. Qualification and licencing requirements need not, in the Committee's view, be applied to these individuals.

- 14.9 Persons who, for a fee, review, evaluate, recommend or advise regarding an insurance contract but do not place any insurance business with an insurance carrier should not, in the Committee's opinion, be included in licencing and associated qualification requirements. The consumer will be required to judge the competence of persons who hold themselves out as "insurance consultants" based on reputation and past performance. Alternatively, the consumer can choose to turn to a licenced broker who likewise acts as a consultant on a fee for service basis.

- 14.10 The Committee concludes that qualifying examinations and standards for agents and brokers be set by industry peer groups, subject to approval of the Superintendent. The Committee suggests that qualifying courses or examinations, as set by the peer group, be administered by the Insurance Institute of Ontario.

The Committee considers the association of Independent Insurance Agents and Brokers of Ontario and the Toronto Insurance Conference to be sufficiently representative of their peers and more specifically of non-exclusive agents to be leading participants in developing qualification standards for all agents and brokers. Qualification under the standards set or administered by these various industry groups should not, however, require membership in these groups.

- 14.11 The Committee has considered a mandatory requirement for requalification of all agents and brokers but has concluded that this requirement is unnecessary at the present time, likely inefficient and of doubtful benefit. The Committee believes that the incentive to maintain competence should be otherwise established in the industry, for example through encouragement of voluntary participation in I.I.O. and I.I.A.B.O. continuing education courses. It would in fact be unfair to impose a requalification requirement on agents and brokers, when there are no such requirements imposed on the professions recognized in statute and when there is no evidence of widespread incompetence.
- 14.12 The licence of an agent or broker expires annually and must be renewed. The Committee views the annual renewal procedure as necessary and moreover directs the attention of the Superintendent to more careful monitoring of expired licences to make certain that unlicensed persons do not continue carrying on business as agents or brokers.

D. QUALIFICATIONS OF ADJUSTERS

An "independent" or proprietor adjuster must be licenced to practice in this Province. To become licenced, an individual is subject to the completion of a course of apprenticeship and the passing of an oral qualifying examination before an Examining Board made up of other adjusters. A recommendation is then made to the Superintendent for the granting of a licence. These qualification procedures do not apply to company adjusters who adjust losses solely on behalf of their employers. Nor is this group subject to licensing.

The Committee's observations regarding the utility of qualification standards with respect to agents and brokers apply equally well in the case of adjusters. One point of difference is found in regard to the broader requirement for licencing. In the case of agents and brokers, licencing is in large part necessitated by reason of the agents' or brokers' handling of premium funds; this aspect does not exist in regard to adjusters as only relatively few handle claim funds and then only on a draft basis.

The Committee's conclusions regarding the topic of qualification standards for adjusters follow.

- 14.13 The Committee reaffirms its conclusion in the First Report that the insurance company on whose behalf an adjuster operates, even on a case-by-case basis, should be entirely responsible for the adjuster's conduct. The First Report further concluded that the Superintendent enjoys adequate authority over the actions of company adjusters and their qualifications, by his authority over licenced companies which are their employers.

In reaffirming these conclusions, the Committee questions the need for the licencing of "independent" or proprietor adjusters and encourages the Superintendent to examine this matter. Without the licencing requirement, insurance companies who employ proprietor adjusters would have to accept a much greater explicit responsibility for their activities and for their qualifications to adjust claims.

- 14.14 So long as the present licencing requirements continue, the Committee concludes that qualification standards should be maintained as an integral part of the conditions of practice of "independent" or proprietor adjusters. The qualifying standards should be set by an industry peer group, subject to the approval of the Superintendent. Administration of courses and possibly examination should be undertaken by the Insurance Institute of Ontario, as an industry-wide educational organization.

E. QUALIFICATIONS OF OTHERS ASSOCIATED WITH THE INSURANCE PROCESS

- 14.15 The Committee repeats its recommendation in the First Report that persons without a licence or in the employ of unlicenced insurers should receive the permission of the Superintendent and pay a required fee before operating in this Province as special agents, brokers or adjusters.

The requirement to seek permission would apply, for example, in the case of foreign adjusters, employed by unlicenced, offshore insurers or by

non-resident, licenced insurers and in the case of offshore brokers serving domestic customers and placing business in local insurance markets.

The Committee notes with concern that in the Report of the Provincial Auditor to the Legislative Assembly, for the year ended March 31, 1978, a test review of special insurance broker licences revealed eight instances where licences had been issued to persons who did not comply with the requirements of a written application under oath and delivery to the Superintendent of security of not less than \$5,000, as indication that the licensee would comply with The Insurance Act.

CHAPTER 15

Standards of Conduct in the General Insurance Industry

A. MODES OF REGULATING INDUSTRY CONDUCT

Qualification standards are only a starting point in the development of a high level of service from the general insurance industry. Attention as well must be addressed to the standards of conduct in the industry as principal factors associated with continuing quality of service.

There has traditionally been shared responsibility between government and the industry in establishing standards of conduct to protect the consumer. However the authority for setting and enforcing standards has legally and in practice resided in the Office of the Superintendent. Various means by which the conduct of persons in the insurance industry is at present governed and might be governed are set out below, followed by the Committee's conclusions on the matter of regulating conduct.

1. Provisions in The Insurance Act

The Insurance Act in broad terms provides the Superintendent with the duty and authority for "general supervision of the business of insurance in Ontario". In accordance with such, the Superintendent has the authority to issue guidelines or propose that regulations be promulgated by the Lieutenant Governor in Council to guide the conduct of persons in all sectors of the insurance industry. As an ultimate enforcement of his authority in overseeing industry conduct, the Superintendent is able to instigate proceedings for licence revocation.

Various provisions in The Insurance Act are more specific in regulating the business of insurance companies with respect to insurance contracts, rates, business practices, investments and other financial requirements. Of general application to all persons in the insurance industry are the provisions of Part XVIII which name nine acts and practices deemed to be unfair or deceptive. Part XVIII also provides the Superintendent with the duty to determine further what constitutes unfair and deceptive acts and practices aside from the nine specified and with the duty to monitor or, at least, respond to complaints of acts or practices which could be termed unfair or deceptive. The Superintendent has the authority to investigate a business for this purpose and to order a person to cease engaging in the business practice found to be in contravention of this Part of the Act. It is important again to note that all persons in the insurance industry fall under the provisions in Part XVIII.

To the extent that certain industry actions, which are not unfair or deceptive, result in a poor quality of service or a dissatisfied customer, the provisions of Part XVIII are insufficient to establish and enforce a satisfac-

tory standard of conduct in the industry. Other concerns regarding Part XVIII were expressed by the Committee in its First Report,¹ where it was commented that Part XVIII has put the Superintendent in the position of being, in a sense, legislator, prosecutor and judge in certain circumstances. The nine acts and practices defined as unfair or deceptive in Section 388 are non-inclusive and, therefore, permit the Superintendent to determine whether other acts and practices should be considered as unfair or deceptive.

2. Reference to the Common Law

When the consumer feels he is being improperly treated by the insurance industry, he has recourse to the common law, to contract law and to statutes governing business practices and consumer protection.

Common law liability is applicable to the agent or broker as a result of the insured's reliance on the agent for advice and the agent's corresponding remuneration for this service taken out of the premium paid for coverage. As a result of this relationship, a standard of competence and a duty of care is imposed on the agent under the common law, as defined by Mr. Justice Fraser in "*Fine's Flowers Ltd. versus General Accident Assurance Co. of Canada*".²

The right of civil action by the consumer against an agent or an insurer acts as a deterrent to incompetence and unsatisfactory conduct. However, the Committee is concerned about the effectiveness of this deterrent in situations of a mediocre quality of service which the consumer may not recognize as unsatisfactory or in situations where the consumer is not sufficiently motivated by an award of compensation to turn his complaint into a legal action.

A second aspect of the recourse to common law is that it can provide the claimant with compensation incurred as a result of incompetent or negligent conduct. In this regard, the common law as a regulator of conduct has an advantage beyond that of other methods of conduct enforcement.

Thirdly, recourse to common law in matters of conduct has the advantage that the civil suit system reflects changes in norms of conduct in current terms without the need to set out standards beforehand. On the other hand, the case-by-case determination of conduct under common law makes this a difficult means of enforcing broad norms of conduct efficiently.

3. Proposed Amendments to Part XIV

In the proposed amendments to Part XIV of the Act, as outlined in Chapter 5,³ a proposal has been made to prescribe in The Insurance Act

1. *First Report on Automobile Insurance*, page 216.

2. *Supra*, page 69.

3. *Supra*, page 69.

certain statutory duties of care of a general lines agent to those insurers for whom he or she acts and to the public. As a result, the Superintendent would assume the responsibility of ensuring that these duties of care are met and to act upon the situation whenever they are not met.

It is evident that the duties to be prescribed in the Act cannot be as comprehensive as the common law in covering situations of poor quality of service. Yet prescription of duties in statute would formally establish at least the minimum expectations of the public regarding the role and responsibilities of the agent or broker and would also appear to establish cause for civil liability actions. For example, the principle proposed duty to advise the insured of "types and extent of insurance coverage available" would appear to support a civil action should advice be carelessly or negligently given. At the same time, failure to advise would be in contravention to The Insurance Act and cause for licence revocation.

4. Competition as a Regulator of Conduct

Competition or the operation of market forces is considered in theory to be the best regulator of conduct in producing satisfaction of individual consumer interests as well as efficiency and an optimum level of service.

The Committee has concluded that, in Ontario, insurance companies should continue to be given the opportunity in the future to demonstrate that they can meet the public interest with a minimum of government regulation of their business and conduct. In certain areas, such as solvency and group merchandising, the Committee has recommended a review of provisions in the Act or of guidelines set by the Superintendent with a view to relaxation of the rules presently applied. However, for the time being, the Committee has recommended the retention of the authority of the Superintendent to oversee the industry in its operations.

In regard to the agent or broker, it is not as readily apparent that competition can act as an effective regulator of conduct. The agent or broker provides a service rather than a tangible product and this service is provided to two different, and likely conflicting, groups. The services of the agent may be easily evaluated by insurance companies, as one of the buying groups. They are oftentimes less easily evaluated by the second group, represented by those persons seeking advice on insurance coverage. The following explains further the difficulty in relying on competition as a regulator of the conduct of agents or brokers.

The consumer approaches the agent on the basis that, by purchasing the insurance product through the agent, he will have made an informed purchase decision. The agent is charged with the responsibility of advising on, if not in practice making, a purchase decision for his client: for this he is compensated. The client must have *confidence* in the agent for this ser-

vice relationship to work, particularly if the client is not able to evaluate the quality of advice or service provided.

“Confidence” is not a clearcut or well-defined matter which lends itself to competitive selection. As a result, competitive market forces are unlikely to assist the consumer in choosing an agent he can trust to serve him in the most conscientious, responsible manner. Other means of establishing and enforcing a standard of duty and conduct appear to be required in the area of agents’ or brokers’ services.

Given that most agents and brokers deal with the less sophisticated consumers of insurance products, the need for regulation of conduct, by means other than competition, is reinforced. The unsophisticated buyer often may not recognize that he is being poorly served and is therefore less likely to engage in the comparative shopping and agency switching behaviour that permits the regulation of conduct by means of market forces.

5. Objectives Defined by Industry Organization

The importance of a reputation for good service to the consumer has been recognized by various associations within the insurance industry which have established objectives of conduct for their members, as a means of assuring the public that members will act in the public interest. The Insurance Bureau of Canada, The Independent Insurance Agents and Brokers of Ontario, and The Ontario Independent Adjusters Association among other organizations have established a formal set of objectives for their members. At the present time these groups have limited powers of enforcement of their conduct objectives, as an offending member is able to continue doing business even if his membership in any one of these associations is withdrawn.

6. Industry Self-Regulation

An alternative to the responsibility of the Superintendent to set standards of conduct and supervise conduct in the insurance industry is the delegation of such responsibility to an industry group. Delegation would only be effective if the industry group is able to exercise powers of enforcement and ultimately is able to prevent a person from carrying on the business of insurance by withdrawing a licence or other right to practice.

Various forms of government regulation and self-regulation are possible based on the division of responsibility for *defining* standards of competence and conduct and on the division of responsibility for *enforcing* these standards. The issue of self-regulation is currently being addressed by both the Ministry of Consumer and Commercial Relations and by agents, brokers and adjusters in this Province.

Self-regulation is supported by a number of advantages. One advan-

tage is the establishment of a code of conduct by members of the self-regulated group who are most familiar with the quality aspects of the service they provide. In addition, compliance with quality standards is enhanced by allegiance to a self-regulating group and the “peer pressure” that is developed in such a group. A third advantage is that enforcement of the role of conduct is undertaken by informed persons who are familiar with the norm of competence required in the industry.

Self-regulation is not without disadvantages. It implies the need for persons to join a particular group in whose total interests they may not wish to participate. A further significant disadvantage to self-regulation is the possibility that conflicts of interest will arise in discharging responsibilities to the group and to the public, thereby weakening the development and the enforcement of a code of conduct that is in the public interest. For example complaints about matters much as excessive delays or high fees may be downplayed while competitive behaviour such as advertising of services may be penalized.

B. OBSERVATIONS ON REGULATING INDUSTRY CONDUCT

As the Committee has stated earlier there is no method of guaranteeing a more satisfied customer and a better level of service in the general insurance industry. Standards of conduct, while principal factors associated with continuing quality of service, cannot provide a guarantee of a high level of service although they are positive efforts toward better service in the insurance system. Accordingly the Committee makes the following observations and conclusions on the available modes for regulating conduct.

- 15.1 The Committee reaffirms its conclusion in the First Report that Part XVIII of The Insurance Act, which includes a list of nine unfair and deceptive acts or practices, should be amended to permit the Lieutenant Governor in Council to make regulations defining such acts and practices as found to be appropriate to regulate conduct in the general insurance industry.

Amendment of Part XVIII will result in a more flexible regulation of conduct that is adaptable to changing market conditions, ways of doing business, and the adoption of new regulatory modes within the insurance industry or any of its sectors. At the same time it will limit the Superintendent’s authority to those matters defined in regulation. It is the Committee’s expectation that the making of regulations should be considered in the context of a minimum regulatory burden on the insurance industry.

- 15.2 The Committee proposes that tied selling be prescribed in regulation under Part XVIII as an unfair practice. The practice of requiring the purchase of one general insurance coverage as a condition of supplying another insurance product or any other product is generally prohi-

bited under the federal Combines Investigation Act and, in the Committee's opinion, should as well be prohibited by regulation under The Insurance Act.

- 15.3 The Committee has reviewed with interest recent proposals for amendment of Part XIV regarding the general duties of sales intermediaries. Of specific interest in regard to conduct and the level of service to the consumer is the proposal for a statutory duty of care to be prescribed in The Insurance Act requiring the general lines agent to "advise those members of the public with whom he deals of the types and extent of insurance coverages available through him in the best interest of the insured or proposed insured". The Committee concludes that reference should be made in The Insurance Act to the general duties of an agent, broker and adjuster, both to the insurer and to the insured public; that these duties should be broadly defined; and that they should include the duty to advise the public of the types of available coverages. The Committee emphasizes, however, that in the case of agents or brokers the provisions in the Act should not override the duty of care established in common law and the ability of the insured to recover damages as assessed by a court.
- 15.4 The Committee recommends that intermediate penalties, as well as the penalty of licence suspension, be provided for in the Act in the event that the duties defined in the Act are not met to the satisfaction of the Superintendent.
- 15.5 The Committee repeats its recommendation that the regulatory mode for supervising the conduct of insurance companies should be the monitoring of competition. Together with the review of other guidelines or regulations pertaining to solvency and group merchandising, and with the review and updating of Part XVIII of the Act dealing with unfair or deceptive acts and practices, the monitoring of competition as a mode of regulation will place a greater burden on the insurance industry to examine the conduct of its members and make improvements in the public interest.
- 15.6 Over the last two years, since its first investigations into automobile insurance, the Committee has been watching with interest the development of industry groups toward self-responsibility.

The Committee has recommended in this Report that the industry associations representing proprietor agents and adjusters should be given the responsibility of establishing qualification standards as part of the accreditation for licencing. The Committee encourages these same industry associations to demonstrate their ability to establish and *enforce* a code of conduct that will result in a high quality of service to the consumer and will justify the confidence placed by the consumer in the advice provided by the agent or

broker. At the same time, the Committee cautions the insurance industry against building up accreditation or quality of service standards as excessive barriers to the entry of new industry participants or as contributors to an unnecessarily higher cost of service in the industry.

PART VIII

LOSS PREVENTION

CHAPTER 16

Consumer Protection: The Role of Loss Prevention

A. OVERVIEW

To this point, the fundamental concern of the Committee has been the ability of the private insurance industry to carry on the business of transferring and distributing the cost of losses, with due regard to the public interest. The Committee's focus of concern corresponds to the historical development of the industry as a mechanism for indemnification after the incident of loss. Only certain lines of insurance, such as surety bonds, boiler and machinery coverage and title insurance, have developed from a loss preventative viewpoint as a prime consideration.

The Committee wishes at this time to turn its attention to the broader matter of *consumer protection*. Protection is a fundamental need of the consumer which can be satisfied through purchase of insurance or through insurance combined with loss prevention. In order to *maximize* consumer protection, the latter alternative appears to be most effective. In effect, the problem of losses can in many instances be attacked more usefully by measures that prevent the occurrence of events of loss and their dislocative consequences.

The insurance system, which absorbs a large proportion of total losses, can function more efficiently when combined with loss prevention. If measures are taken to reduce the incidence of events resulting in loss claims, the industry will be able to deal more effectively with the losses that remain and loss distribution through the insurance system will impose a lesser premium burden on the individual policyholder. Accordingly, a shift in emphasis from loss payment to loss prevention will benefit the consumer.

In broader terms, insurance without loss prevention is not a viable or healthy approach toward coping with losses. Insurance cannot redress all the losses suffered as a result of fire or other peril. Examples provided to the Committee supporting this statement follow.

1. Property losses due to fire were \$157 million in Ontario in 1977, close to 30 percent of the total in Canada. These loss figures are for property damage only and do not include the many additional costs of temporary accommodation, business interruption and so on. In Canada as a whole, the indirect economic cost of fires is estimated to be \$2.1 billion annually.
2. In 1976 in this Province alone, 55 incidents of fire resulted in large losses of \$250,000 or more. These losses were disruptive not only to the owners of property but had further indirect consequences on employees, local communities and so on.

3. Estimates provided to the Committee indicate that of all businesses suffering a major fire loss in the United States, 43 percent never resume operations; 28 percent fail within 3 years; and only 23 percent fully recover. The consequences of such disruption of business activity are widespread and of major concern within the economy.
4. In 1976, 1,532 persons in Ontario were injured in fires, while 265 persons died. In the same year, 1,511 persons died in automobile accidents.
5. Ontario residents are spending \$200 million annually on municipal fire protection services, with much of this expenditure related to fire suppression.
6. Vandalism is the cause of 44% of investigated incendiary fires in Ontario; fraud is the cause of about 5%. In 1977, incendiary fire losses were estimated to total \$27.5 million or 17% of the total property losses due to fire. In 1977 in Toronto, 323 cases of incendiary fires occurred with a dollar loss of about \$3.7 million. Incendiary fires accounted for about 11 percent of all Toronto fires. Loss prevention in this area is of particular concern to ensure that the incidence of this type of community crime does not become a major burden in terms of loss costs.
7. Ontario residents are spending over \$500 million annually on property insurance premiums, with a significant proportion related to fire losses. This money spent on risk aversion is not available for other expenditures.

These are only some of the costs associated with property losses in Ontario—costs which are easily identified and mainly related to incidents of fire. The total cost of losses, even if difficult to define in precise dollar amounts, is evidently of major significance in economic terms.

B. RESPONSIBILITY FOR LOSS PREVENTION

In attempting to maximize consumer protection, there is a need to determine the appropriate balance of responsibility for loss prevention among:

- individuals or businesses;
- insurance companies; and
- public bodies.

Many *individuals and businesses* are motivated to undertake their own loss preventative measures. In the case of individuals, efforts at loss prevention include: good housekeeping, home maintenance and even attention to personal habits such as smoking; installation of loss control systems, such as burglar alarms, smoke detectors, fire extinguishers and other security devices; and attention to the construction characteristics of a home, the electri-

cal and mechanical system in the home, the location of the home, and so on.

However, it is unrealistic to assume that the major onus for loss prevention can be put on the individual or business enterprise, for the following reasons:

- Individually, members of the public may not be able to control or eliminate all the hazards affecting them;
- Individuals cannot always afford to engage in loss control practices that will be effective;
- Loss control is often a highly technical service;
- The chance of loss may appear, in some cases, to be so remote that the effort at loss control may seem futile to the homeowner, tenant or businessman;
- In many situations, the individual or business becomes the innocent victim of circumstances outside his or its control.

The *insurance industry*, for the most part, does not explicitly sell loss prevention services. Nevertheless, some companies and brokers, recognizing a demand for “protection” rather than insurance per se, provide extensive loss prevention counselling and engineering services. The insurance industry has, as well, expressed concern about increases in the incidence of losses and has recognized that it does have responsibilities in regard to loss prevention, if only in its own interests to control the dollars paid out on loss claims. It has in any case demonstrated its commitment in this area in a number of ways to be discussed below.

More directly, the insurance industry has reacted to measures that reduce losses and loss costs through the rates it charges. In general, industry ratemaking is responsive to changes in *total* loss costs. In addition, the insurance industry provides individual incentives, in the form of lower rates, toward loss reduction in the case of individually rated commercial risks and in the case of automobile insurance, where lower rates are charged for a claims free record. However, individual incentives for loss protection are not provided in any consistent manner in the personal lines of property and casualty insurance.

Governments have historically assumed extensive responsibility in protecting the public from losses. Examples of public protection include:

- police and fire protection systems;
- fire and building code standards;
- government control over hazardous substances;
- zoning bylaws that prohibit an accumulation of hazards;
- government participation in other public safety measures, such as inspections.

16.1 The Committee concludes that the major burden of responsibility in

providing consumer protection through loss prevention falls on public measures. In many instances, community action and public safety regulations are the most effective means of controlling the incidence of loss. The Committee emphasizes the importance of and the need for efficient and effective loss prevention and protection services provided by the public sector.

- 16.2 At the same time, the Committee reminds the insurance industry of its responsibility to contribute to public efforts at loss prevention. The Committee feels that the insurance industry should take on a greater cooperative role in loss prevention than it does at present.
- 16.3 In addition, the Committee encourages the insurance industry to develop and sell loss prevention services wherever it can identify a demand for "protection" rather than for claims settlement alone.
- 16.4 The Committee also urges the insurance industry to be more innovative and responsive in its ratemaking, so as to provide more premium incentives for loss reduction, particularly in residential lines.

C. SPECIFIC ACTIVITIES

At the present time, government activity is combined with industry initiatives to increase consumer protection in a number of areas, including:

1. Fire protection and suppression,
2. Investigation of losses,
3. Loss control through hazard identification:
 - pre-loss inspection,
 - implementation of loss control systems,
 - collection of data on losses,
4. Safety standards and government inspections,
5. Other areas of loss prevention:
 - research and development into product and safety standards,
 - training of personnel in loss prevention and control,
 - education of the public.

The Committee comments in the remainder of this chapter on the degree of emphasis it feels should be placed on government responsibility in the above areas and the desirability of insurance industry contributions to improve loss prevention.

1. Fire Protection and Suppression

The Ontario Fire Marshall reports that fire losses in the last five years in this Province have been growing in dollar terms in the range of 5 to 10

percent per year, to a total value of \$157 million in 1977, as shown in the Table below.

Year	Number of Fires	Total Fire Loss (\$ Million)	Fire Loss per Capita	Fire Deaths
1973	24,721	\$114.8	\$14.67	212
1974	24,367	128.9	15.93	281
1975	23,913	131.6	15.99	277
1976	23,109	143.1	17.60	265
1977	24,610	156.7	18.61	238

The upward trend, although steady, is not dramatic, particularly when consideration is given to the trend in inflation.

Responsibility for fire protection, suppression and investigation is dispersed among three levels of government. Primary responsibility for fire protection as a public service is assigned to the Province, but is, for the most part, delegated to the municipalities. There are no uniform criteria for fire protection services among municipalities. The quality of services depends to a large extent on municipal financial support for such projects as adequate firefighting equipment, an adequate water distribution system and location of firehalls within a quick reaction distance from most properties. It is evident from the dispersion of responsibility and funding of fire services among municipalities that the quality and effectiveness of local fire departments varies substantially throughout the Province.

Pre-fire loss protection services also fall within the scope of municipal fire departments. However, pre-fire activities, such as a systematic programme of fire inspections, appear to be regarded as less critical than fire suppression.

The Office of the Ontario Fire Marshal provides coordination of fire services in the areas of fire investigations, training and advisory functions, technical and consulting services and the Ontario Fire Incident Statistical reporting system. The advisory function of the O.F.M. is directed mainly to volunteer fire departments. The Ontario Fire Marshal also coordinates the activities of the Ontario Fire College for the training of municipal fire fighting personnel.

Insurance companies take account of the level of fire protection services in a municipality in determining the cost of property insurance coverage. A *grading of municipalities* is performed, on behalf of the Insurance Bureau of Canada, by the Public Fire Protection Survey Services Division of the Insurers' Advisory Organization. Inspectors gather information and prepare reports on the fire-fighting and fire prevention facilities in a municipality, investigating in addition to the fire department, the water system, the fire alarm system, the fire protection codes and the building codes in a municipality. The findings of P.F.P.S.S. inspectors are made available to the

municipality in the form of recommendations for improvements of public fire protection facilities. Insurance industry inspectors also assist municipal fire departments by providing technical advice, education and training seminars and demonstrations.

16.5 In general, the Committee sees an array of efforts at all levels of government to cope with the fire threat to property and life. The delegation of major responsibility to the municipalities has resulted in disparities in firefighting service with a resulting differentiation in insurance rates. The Committee emphasizes the need for greater coordination in the provision and upgrading of fire abatement services in municipalities across the Province and urges the provincial government to devote more study to this matter.

2. Investigation of Losses

Organizations Involved in Investigation

Numerous participants are involved in the loss investigation process, with interest in somewhat differing aspects of the loss. The insurance industry routinely carries out an investigation of losses as part of its claims settlement process. The insurance adjuster collects information on the cause of loss as well as determining the amount of damages. In the case of fire losses, municipal fire departments, assisted on occasion by the Office of the Ontario Fire Marshal, conduct an investigation into the cause of each fire loss.

Municipal fire departments, the Ontario Fire Marshal, police departments, and The Insurance Crime Prevention Bureaux' investigators also investigate losses for reasons related to control of crime-related losses. Arson, motor vehicle theft, vandalism and burglary are examples of incidents of crime-related losses.

The Ontario Fire Marshal, in particular, is assigned the responsibility of detecting whether a fire or explosion has been caused by malicious or criminal activities, in order to effect criminal charges that will act as a deterrent to further crime-related losses. The Ontario Fire Marshal also investigates fatalities, large loss fires, gaseous explosions as well as fires of a suspicious nature.

The Ontario Fire Marshal reports that arson fires, defined as incendiary or set fires, have been taking on an increasing share of fire losses in this Province. Investigated incendiary fires numbered 1,233 in 1977 and accounted for \$27.5 million or 17 percent of the value of fire losses compared to \$21.5 million or 15 percent of the total in 1976. It is reported that, on an all Canada basis, the share is larger—or about 30 percent of the losses from all fires across Canada.

Vandalism is the primary cause of investigated incendiary fires, ac-

counting for about 44 percent of the total arson fires. Arson for purposes of insurance fraud represents only about 5 percent of total set fires and is not therefore a dominant factor in the cause of fires. Other causes of set fires in 1977 included fires to conceal crime, for revenge for some presumed wrong, by people with mental disorders and about 12 percent caused by unknown persons.

The Committee is informed that arson is becoming a major concern to insurers, who are disturbed by indications of possible rapid growth in the arson rate occurring during the next decade. Arson is a community crime which reflects various social and economic problems and hence is best tackled by community measures aimed at preventing such fires. Further measures include arson investigation and detection and the Committee is informed of increased efforts in this regard to be undertaken by the Ontario Fire Marshal in close cooperation with local police and fire departments.

16.6 The Committee recognizes arson as a disturbing, although not yet dominant factor, in increasing insurance costs. The Committee is most concerned by recent evidence of the growing seriousness of this crime, largely as linked with vandalism.

The Committee concludes that the seriousness of arson must be recognized in appropriate penalties commensurate with the extent of damages suffered by the community and that the necessary public resources be devoted to the investigation of arson fires and the apprehension of those persons who set these fires.

The Insurance Crime Prevention Bureaux

The insurance industry supplements public activities in keeping crime-related losses under control through its support of The Insurance Crime Prevention Bureaux (I.C.P.B.). This non-profit organization provides services in the detection, investigation and prosecution of insurance and insurance-related crime.

The bureaux's main activities involve investigations of suspected crimes and are of two types:

- discovery and prosecution of persons fraudulently collecting insurance money; and
- identification and prosecution of persons who commit crimes, such as theft, in which insurance loss is the result. In regard to theft, the I.C.P.B. reports that the dollar loss due to break-ins and major thefts over a two year period in Toronto is estimated at \$52 million and the total value of goods recovered at only \$2 million.

The activities of the I.C.P.B. are carried out under two branches: the Fire Underwriters' Investigation Bureau (F.U.I.B.), which concentrates on crime arising out of fire losses, and the Canadian Automobile Theft Bureau

(C.A.T.B.), which is concerned primarily in Ontario and Quebec with organized theft of vehicles for resale or parts stripping as well as with individual thefts and motor vehicle burnings.

The I.C.P.B. indicates that, during the years 1972 to 1977, it investigated 344 claims in Ontario where fraud was suspected, claims were denied, dropped, compromised or are still in litigation. In 1977, 104 such cases were investigated in Ontario, with the insurance at risk amounting to \$10.9 million.

An ancillary activity of the Bureaux is the provision of an index on property losses that includes a record of claims submitted by individuals across Canada. Member insurance companies use the index for underwriting purposes to identify claimants with a record of frequent claims. Other ancillary activities include provision of counselling services and training programmes for insurance, fire investigation and law enforcement personnel and, additionally, surveillance and other protective measures in cooperation with the appropriate authorities to prevent or discourage criminal activities.

16.7 The investigation activities of the Insurance Crime Prevention Bureaux appear to be a worthwhile and effective industry initiative toward reducing the incidence of crime-related claims in the insurance system. It is apparent to the committee that the mere fact of the existence of I.C.P.B. likely acts as a deterrent to certain types of insurance crime. The I.C.P.B. carry out an investigative role which is more detailed in time or expertise than can be undertaken by publicly funded fire and crime investigation services. In carrying out this role, the Committee emphasizes that the I.C.P.B. must continue to cooperate fully and coordinate its activities with the appropriate fire and police investigative authorities.

3. Loss Control Through Hazard Identification

Pre-loss inspection, implementation of loss control measures and collection of data on causes of loss are three areas of loss control activity which are interrelated in that they are concerned with some aspects of hazard identification. Furthermore, they have the potential to influence the ratemaking process to reflect more accurately differences in hazard. The Committee finds that this potential is not well developed in certain insurance lines, particularly in residential lines, as is described below.

Pre-loss Inspection

A direct approach to loss control is that of routine inspections of risks, accompanied by a report recommending improvements that will reduce hazards. Pre-loss inspection activities are at present carried out by private insurers for their own policyholders; by the Insurers' Advisory Organization in regard to the commercial, industrial and institutional risks insured by

member companies; by municipal fire departments as part of their fire prevention service; and by municipal building inspectors in correspondence with local building codes and bylaws.

Greater attention is paid to commercial risks in the conduct of pre-loss inspections. Inspection activity regarding residential risks is limited; for example, some fire departments conduct door-to-door campaigns, but they have no authority either to gain entry for inspection or to enforce improvements when deficiencies are identified.

Pre-loss inspection of residential property is not generally carried out by the insurance industry. Even when inspections are carried out they are usually for the purpose of determining the class of risk into which the property falls and not to identify potential hazardous conditions. In practice, pre-loss inspection of residential risks by the insurance industry is of little direct economic benefit to either the insurer or insured. The cost of conducting an inspection cannot be justified by the insurer in terms of the premium volume obtained on habitational risks. From the viewpoint of the consumer, the demand for inspections is limited by the fact that hazard differences discovered in the course of an inspection are not recognized in personal lines ratemaking and will generally not be recognized by a premium differential.

In contrast, in most commercial lines, hazard features are recognized and incorporated in the rating of many risks. The insurance industry routinely inspects most commercial risks in order to collect the underwriting information required to rate these risks on the basis of their individual hazards. The Insurers' Advisory Organization, as part of its services to its members, engages in individual risk inspection of commercial properties and in this process identifies conditions which may cause injury, loss of life or damage to property. Inspection services are being broadened to include liability and crime hazards.

16.8 The inspection of residential properties does not appear to be a cost-effective measure for the insurance industry to undertake, although savings could be achieved in the insurance system through a general reduction in home hazards. Accordingly, it is the Committee's view that greater responsibility for risk inspection should fall on the municipal fire department, as part of increased emphasis on public fire prevention. The Committee makes the recommendation to municipal fire departments that door-to-door inspection campaigns be given a higher priority by the local fire departments, as educational efforts which alert residents to fire hazards and the need for their reduction.

Implementation of Loss Control Measures

The insurance industry, to varying degrees depending on the type of risk or the type of insurer, encourages implementation of loss control measures, such as sprinkler system installations, among commercial property

risks. However, the Committee earlier expressed its concern that the commercial property lines rating system which applies credits and debits related to hazards requires improvement, particularly in regard to the statistical justification of the various credits and debits applied to hazard differences.

Little is done in regard to incentives for implementation of loss control measures on residential properties. The Committee's view is that more should be done, first, in identifying factors that have a potential bearing on loss control and, second, in undertaking to track loss experience related to these factors to determine whether rate differences can be justified statistically.

16.9 The Committee encourages the insurance industry to explore ways of providing incentive for *individuals* to undertake loss prevention in regard to their personal property. Specific attention should be given to the applicability of providing industry-wide discounts for installation of loss prevention or protection systems which may include smoke detectors, anti-burglary devices, home fire extinguishers and other common precautionary devices.

As detailed in Chapter 11 of this Report, potential risk reduction factors would necessarily have to be included in statistical plans for collecting loss experience data in order to demonstrate their validity as rating factors.

Collection of Data on Causes of Loss

Collection of data on causes of loss is essential to the insurance industry in its ability to underwrite risks profitably and equitably. It is further essential to the industry as the basis for determining what factors affect loss, how losses can be controlled, and hence the validity of encouraging loss control through premium incentives. These matters have all been the subject of the Committee's discussion in various sections of this Report.

The collection of data by the insurance industry on the causes of loss is also of potential value outside the insurance system as an input into public efforts at reducing loss. In fact, the insurance industry is the only source of information regarding certain kinds of losses. In some cases, analyses of these data may be socially useful; for example, in assisting the government to set and enforce safety standards. In regard to fire statistics, it is recognized that there is a need for better data on fire losses to assist in the development of better building and product standards that are based not simply on historical judgment but on sound data. In regard to liability losses, there is in general little public information, outside of reported court cases, detailing the costs of liability claim settlements by type of accident or type of damages incurred.

16.10 The Committee encourages the insurance industry to generate and

analyze more and better data on detailed causes of loss. These data are essential to a more accurate ratemaking process and may be useful sources of information to public bodies and to the business community. The Committee also encourages the insurance industry to participate in providing data to public statistical programmes regarding fire and non-fire losses. A greater coordination of data resources between the insurance industry and public bodies should be developed to assist in a better pooling of information on the causes of loss. The Committee concludes that the initiative in making public, information on the causes of loss should fall on the insurance industry.

4. Safety Standards and Government Inspection

A special area of loss control activity is that of government inspections in enforcing safety standards in regard to a number of products and operations, including boilers and pressure vessels, elevating devices and amusements to name only a few. As an alternative to government inspection, certain safety standards could be enforced by placing the responsibility for inspection in the hands of the insurance industry, by making some form of insurance and inspection for these products and operations compulsory.

This latter approach to safety standards was the subject of discussion by the Committee with representatives of insurance companies who offer boiler and machinery coverage and with representatives of the Ministry of Consumer and Commercial Affairs under whose jurisdiction fall government inspections of boilers and pressure vessels. To meet the requirements of the Boiler and Pressure Vessels Act, the Pressure Vessels Branch of the Ministry carries out inspections on both new boilers under fabrication and, periodically, on pressure vessels in operation. Thirty-eight inspectors are employed by the Branch, with 25 involved in inspection at the point of manufacture of new equipment.

In regard to periodic inspections, records within the Branch show that at February 28, 1978, 2,994 periodic inspections were overdue, while some pressure vessels have not been inspected for several years. The Boiler and Pressure Vessels Act requires annual inspection or inspection at periodic intervals as prescribed in regulations. In further examination by the Provincial Auditor, it was found that in some cases as many as seven annual inspections were outstanding for a pressure vessel rather than the one overdue inspection indicated by a computer record. Information provided to the Committee indicated that the backlog of inspections is the direct result of an increasing workload in the Pressure Vessels Branch and a demonstrated need for an increase in personnel.

Of the major proposals which have been considered by the Minister to alleviate this problem, two affect the insurance industry:

1. It has been proposed that the inspections performed during manufacture

be carried out by qualified inspectors employed by an insurance company and not by government. At present all inspections on vessels under fabrication are carried out by the government.

2. It has been proposed further that all periodic inspections be carried out by insurance companies. At the present time, 80-85 percent of pressure vessels installed in this Province are insured under boiler and machinery coverage and hence inspected by insurance companies. Fifteen percent of known operating boilers and pressure vessels are inspected by the Pressure Vessels Branch. Ontario's record of avoidance of accidents is extremely good under this shared system of inspections.

In considering the present inspection situation and the alternative of insurance industry inspections, the Ministry has, during the course of the Committee's studies, announced its decision to continue inspections on new and operating vessels at a cost of about \$1.5 million a year. The government hopes to recover the cost of inspections on newly fabricated boilers and pressure vessels from manufacturers.

The Committee's emphasis of concern in its review of this matter is directed at operating boilers and pressure vessels in this Province; the precautions taken to avoid accident; and the necessity of providing financial protection to third parties who might incur injury or damages in the event of an accident. While it is estimated that 80 to 85 percent of pressure vessels are insured under boiler and machinery coverage and hence inspected by insurance inspectors, liability coverage is often not provided under the boiler and machinery policy, although it may be carried under an organization's general liability coverage.

Compulsory boiler and machinery insurance, including liability coverage as a component, has been suggested as a means of providing protection to third parties and, at the same time, effecting implementation of safety standards through insurance company inspection and rejection of poorly maintained or substandard risks. Those vessels found to be substandard would not be allowed to operate without insurance.

- 16.11 The Committee has reviewed a special area of loss control activity, that being the inspection of boilers and pressure vessels under manufacture and in use in this Province. The Committee concludes, in regard to periodic inspections, that it would not be appropriate for the government to discontinue its service of period inspections of those boilers and pressure vessels which are not insured. If inspections, and consequently public safety standards, were to become the responsibility solely of the insurance industry, the Committee is concerned about the willingness of insurance companies to conduct routine inspections on the smaller boiler and pressure vessel installations in the more remote parts of the Province.

- 16.12 Likewise, the Committee regards continuing government inspection on manufacturers' premises as an essential aspect of public safety. The cost of such inspection should, however, be borne by the manufacturer and hence there is the need for development of fee schedules to reflect the full costs of inspection. The Committee sees no advantage in shifting inspections to the insurance industry if fee schedules and personnel requirements in the Ministry are appropriately revised.
- 16.13 The Committee is nevertheless concerned about the backlog of inspections to be performed by the government inspection service and wonders whether there may also be a backlog of inspections by the insurance industry among insured boiler and machinery installations. There is an urgent need, likely at both levels, to make the inspection process more efficient and timely. The Committee lends its support to the Ministry's intention to study ways of improving the government inspection service.
- 16.14 In regard to compulsory liability insurance on boilers and pressure vessels, the Committee finds that liability for explosion or malfunction of a pressure vessel is normally covered under an organization's general liability policy. Accordingly, the Committee believes that greater emphasis should be placed on the availability and purchase of general liability coverage, at adequate limits of coverage and for a wide breadth of accident situations, including the explosion or malfunctioning of boilers and pressure vessels. The Committee does not see the need at the present time for compulsory insurance on boilers and pressure vessels.

5. Other Areas of Loss Prevention

The Committee has had the opportunity to examine a number of other activities which contribute to loss prevention and control, among which are the following.

- research and development into products and safety standards;
- training of personnel in loss prevention and control and;
- education of the public.

The Committee comments briefly on these activities below.

Research and Development into Product And Safety Standards

At the present time, research into product and safety standards is carried out by various government and industry organizations including the National Research Council, the Underwriters' Laboratories of Canada, the Canadian Standards Association, the Insurers' Advisory Organization, the

Factory Mutual System, the Canadian Industrial Risks Insurers and various consumer associations. These organizations fall into three main groups: public supported bodies concerned about general safety standards; private non-profit organizations working on behalf of manufacturers of products that must meet safety standards; and insurer-supported organizations doing research on behalf of policyholders.

The Committee regards the development of product safety standards as an important loss prevention activity, which, in many instances, is largely a matter of public responsibility. The efforts of private organizations and of the insurance industry in this activity are nevertheless meaningful and necessary contributions to the reduction of hazards in businesses, private homes and public areas.

- 16.15 In further areas of loss control, the Committee encourages the insurance industry in its continuing research into safety standards and loss prevention and in expansion into new areas of research, such as those related to crime and liability losses.

Training of Personnel in Loss Prevention and Control

The insurance industry, to its credit, currently assists businesses and public bodies in training personnel in loss prevention and control through the Insurers' Advisory Organization's School of Loss Control Technology, through the Insurance Crime Prevention Bureaux' talks and lectures given at the Ontario Fire College and Ontario Police College, and through the facilities of the Factory Mutual System and the Industrial Risks Insurers in the United States.

- 16.16 It is apparent to the Committee that the increasing complexity of materials, hazards and construction necessitates better, more sophisticated training of personnel in loss prevention and control. The insurance industry should assume more explicit responsibility in this area, by developing loss prevention expertise internally in the industry and by assisting businesses and public bodies in learning to work towards loss prevention. Continuing and wider support should be given by individual insurance companies to the activities of the Insurers' Advisory Organization and the Insurance Crime Prevention Bureaux in carrying out the training function.

Education of the Public

- 16.17 Education of the public in loss prevention is a key area of loss control activity for both the insurance industry and government. After due consideration, the Committee has concluded that the education of the public regarding standards of care, maintenance and hazardous habits, such as smoking or drinking and driving, is a matter primarily of public responsibility.

The Committee nevertheless considers it to be in the insurance industry's own self-interest, as well as the industry's responsibility as good corporate citizens, to undertake initiatives to educate the public in loss prevention. The insurance industry should find it in its own interest to "sell" education in loss prevention to its larger commercial accounts as an integral service, in the same way it now "sells" claims settlement. Application of this concept at the individual level should also be explored.

In regard to the education of the general public, the Committee also considers that the responsibilities of agents and brokers to advise their clients on coverage needs should encompass some measure of counselling on the topic of loss prevention, if only to remind clients of basic safety precautions.

Need for Coordination

In regard to the foregoing matters discussed in this section, the Committee has been made aware of widespread efforts by insurance industry organizations in various areas of loss prevention. These efforts are valuable and, at the same time, costly. Accordingly, the Committee is concerned about the possibility of duplication of effort in some areas and gaps in other areas.

In particular, in those areas involving public bodies, such as the Office of the Superintendent, the Office of the Ontario Fire Marshal, municipal building inspection departments, fire and police departments and so on, the Committee stresses the need for a review of the separate organizations undertaking loss prevention activities to see if there is a need for coordination.

- 16.18 In reviewing the various government and insurance industry activities in loss prevention, the Committee is led to question whether there is a need for coordination. The Committee suggests that a start in this direction be taken by a review carried out by the Superintendent and the Ontario Fire Marshal, in regard to the research, training, public education and, additionally, collection of data on fire losses, to determine the need for coordination of government and insurance industry activities in these areas of loss prevention and control.

PART IX
OTHER MATTERS

CHAPTER 17

Other Matters

A. INTRODUCTION

A number of specific matters requiring separate consideration were brought to the Committee's attention during its hearings and are dealt with in this Part of the Report. Included as topics in this Part are arbitration in claims disputes, liability insurance concerns, the surety bond market and comments on marine insurance lines. The Committee attaches considerable importance to these matters despite their grouping in this Part of the Report.

B. ARBITRATION IN CLAIMS DISPUTES

The claimant who is in dispute with an insurer has three main alternative courses of action: accept the ruling of the insurer, go to court, or proceed to arbitration. The first alternative will likely leave the claimant dissatisfied while the second may involve considerable time and money and may be avoided by the claimant on the premise that the insurance company has greater resources to employ in court cases. At the present time, the third alternative of arbitration is little used in insurance matters.

In the event of disagreement over the *value of a loss*, Section 122 of the Act, pertaining to the statutory conditions of fire insurance contracts, provides that either party can demand an appraisal. Section 102 outlines the procedure for appraisal. It also provides for appointment of an "umpire" who arbitrates any differences between the appraisers chosen to settle the valuation dispute. There is, therefore, in the case of disputes over the value of fire insurance claims, provision in The Insurance Act for a process of resolving disputes.

Some insurers have voluntarily drawn to the attention of their policyholders their right to appeal to an independent arbitrator when they have a legitimate complaint over the valuation or other aspects of a claim. They have moreover agreed to bear all reasonable fees and costs. Fees chargeable are outlined in regulation made under the Ontario Arbitration Act. One insurance company has gone further and formally introduced an independent arbitration agreement for its personal lines in order to satisfy the claimant that an independent, objective consideration has been given to his claim by a qualified arbitrator.

In a submission before the Committee, the Superintendent of Insurance endorsed a further proposal by the Arbitrators Institute of Canada, Inc., to extend arbitration to *all insureds for all types of disputes*, as an alternative to unsatisfactory claims settlement or court action. It has been suggested by the

Arbitrators Institute that the arbitration process be made available for all variety of general insurance claims disputes including certain third-party cases and commercial claims and that it would be appropriate to use the term "arbitrator" instead of "umpire" in valuation disputes and also to refer to the process of deciding between representations from appraisers as an "arbitration".

- 17.1 The Committee recommends that greater emphasis be placed on arbitration of disputes in the insurance system. Accordingly, The Insurance Act should provide for a process of independent arbitration, according to conditions set out in The Arbitration Act. The process of arbitration should be made available to all insureds in the matter of disputes regarding all general insurance contracts, and not be restricted to the fire insurance contract.
- 17.2 The Committee recommends that the costs of arbitration be borne jointly by the insured and insurer, on a proportional basis to be decided by the arbitrator. The Committee expects that, in most instances, the costs of arbitration will be shared equally by both parties, unless there is an overriding reason which indicates that the demands of one party were unreasonable and hence that party should bear a greater share of the arbitration cost. The Committee also expects that each party will bear its own costs beyond those of the arbitration process.
- 17.3 To effect the recommendations regarding arbitration, the Committee recommends that Section 102 of The Insurance Act, referring to the procedure for appraisals, be broadened to provide for arbitration in all contract-related matters, including but not restricted to appraisal. In the case of disputes requiring appraisals, the appointment of an "arbitrator" should be substituted for the current wording of appointment of an "umpire".
- 17.4 The Committee further recommends that the right to arbitration be brought to the consumer's attention by incorporating reference to arbitration in the statutory conditions which are part of every fire insurance contract and every automobile insurance contract in force in Ontario. In addition, reference to the arbitration process should be included in communication with the consumer, on the application form and on the explanatory brochure or pamphlet material attached to every policy, as proposed by the Committee earlier in this Report.

C. LIABILITY INSURANCE

The matter of civil liability poses a particular demand for insurance that merits separate consideration. There are two basic issues involved:

- the frequency and cost of liability loss settlements, and
- the need for a mandatory requirement that insurance or a recognized form of self-insurance be in force to protect third parties.

1. Frequency and Cost of Loss Settlement

There is ample evidence to indicate that the frequency and cost of liability settlements is rising in Ontario, in the areas of automobile liability, professional liability and products liability, to name only the most obvious examples. Increases in the *frequency* of civil liability claims may be related to a greater exposure to liability situations, for example due to greater traffic density or to rapid growth in professions without sufficient attention to competence. Increases in frequency are likely also related to more assertive consumers, a growing awareness by consumers that insurance coverage is normally available to cover claims and possibly greater aggression on the part of the legal profession. Increases in the *cost* of liability settlements are likely affected by the size of judicial awards, by the greater demands of claimants and by the growing legal and adjusting costs associated with claims settlement.

Most significant to the future frequency of liability claims would be changes in the legislated definitions of responsibility, for example, as a result of introduction of strict product liability as applied in Western Europe and in some U.S. jurisdictions. This topic is currently under study by the Ontario Law Reform Commission. In addition, proposals to extend the right of class actions to new situations could result in both a greater frequency of liability claims and increased costs in the insurance system as a result of liability settlements.

In its Reports on automobile insurance, the Committee examined in considerable detail the issues and costs associated with liability settlements arising out of automobile accidents. The Committee considers it to be appropriate and necessary to reiterate certain of its conclusions and recommendations from its first two Reports in the context of all liability situations as they affect the general insurance industry as a whole.

17.5 The Committee regards the payment of present and future damages on a periodic or instalment basis to be a more appropriate means of compensation for most cases of bodily injury than lump sum payments as made under the present system of compensation. Secondly, the Committee regards as desirable that insurers keep open their files on bodily injury claims to permit adjustments of payments as warranted by changes in the medical condition of the injured person. The intention of the Committee in these recommendations is to draw increased attention to the matter of rehabilitation.

17.6 The Committee in its Second Report stated that it was impressed with the opportunity presented by the no-fault system of compensation to establish a first-party settlement process that provides for direct accountability of the insurer to his own policyholder in the matter of claims. The Committee is further impressed with the direct compensation agreement undertaken by insurance companies in the Province of

Quebec for settlement of third-party vehicle damage claims by the first-party insurer.

The Committee urges the insurance industry in Ontario to examine the application of the latter concept in the field of automobile insurance and in other liability areas. In bodily injury situations in particular, this approach would mean that an insurer providing personal liability coverage to an individual or homeowner would make payment to his insured and then endeavour to collect damages from the insurer of the negligent party. This measure is an intermediate step in the direction of no-fault compensation, as recommended by the Committee for implementation in the automobile insurance system.

- 17.7 The Committee considered in the Second Report the question of non-economic loss payments and their contribution to the cost of liability settlements. The Committee's proposal for a no-fault system of automobile compensation recognized the expectation by the public that some compensation for non-economic losses such as pain and suffering should be made available but recommended that there be limits placed on the amount recoverable.

For "extraordinary" loss claims, the Committee considered \$100,000 to be a reasonable maximum for compensation, as suggested by recent decisions of the Supreme Court of Canada which apply to both automobile and other injury cases. The Committee supports the principle of a limit to pain and suffering awards in all liability situations and sees specific application of this principle in product liability situations.

- 17.8 In the Second Report, the Committee addressed recommendations on the matter of legal costs to the Law Society of Upper Canada regarding:
- vigilance against use of contingency fees;
 - adequate and full disclosure by lawyers of their estimated fees to the client;
 - the need for monitoring of legal costs.

The Committee repeats again its concerns regarding the use of contingency fees as an incentive toward frivolous claims and as a measure that is likely to add to the legal cost of liability settlements. These concerns would be particularly apparent should the right to class actions be extended in the future to new situations. In the Committee's opinion, other means of facilitating access to legal advice and to the courts are available without the need for contingency fees.

2. Mandatory Requirements for Insurance

The Committee examined in considerable depth the need for insurance to cover third-party liability in automobile accident situations. It concluded

the need for compulsory liability insurance to provide protection to the vehicle owner and his family. It furthermore concluded that self-insurance was inappropriate even in the case of commercial enterprises with sufficient financial assets to pay damages to third parties. The Committee's conclusion regarding compulsory liability coverage for motor vehicle owners placed a requirement on the private insurance industry to guarantee availability of this coverage to *all* motor vehicle owners.

In turning to other areas of civil liability, two basic questions are apparent to the Committee:

- Should protection for third parties be a mandatory requirement for doing business or for pursuing certain activities, such as owning a home, piloting an aircraft, owning a motorboat and so on?
- If public protection is to come through a mandatory insurance requirement, is there sufficient certainty as to the ability or willingness of private insurance markets to provide coverage to *all* those persons or businesses requiring it?

No thorough assessment has been made by the Committee outside the field of automobile insurance regarding the public need for mandatory liability insurance. In the case of bodily injury, this issue will likely arise again as ancillary to the Committee's later studies into accident and sickness insurance. The Committee wishes, however, in this Report to address two specific areas where the public would appear to benefit from some form of mandatory liability coverage.

Aircraft and Other Transportation

One area to be considered in regard to the need for compulsory liability coverage relates to the operation of aircraft and to certain to-be-specified classes of marine craft. The Committee views these and other non-automobile forms of transportation as creating substantial risk exposure to passengers and to various third parties who might be damaged by improperly operated or improperly certified air or marine-craft or other vehicles. There is at present no mandatory requirement for liability coverage to protect third parties in these situations.

- 17.9 The Committee recommends that the Superintendent and the Minister consider the public need for requiring, as a start, that all aircraft operating in Ontario carry public liability and passenger hazard insurance at least up to the limit mandatory for automobile liability, presently \$100,000. Liability coverage in such situations should not be breached by improper operation or condition of the aircraft.

Similarly, consideration should be given to the need for mandatory liability coverage in regard to other modes of transportation not included in the automobile category.

Professional Liability

In the case of professional liability situations, the Committee has been informed of the problems of various professional groups in obtaining errors and omissions insurance from private insurance markets. At the same time many professional groups have experienced significant jumps in claims frequency as consumers have become more ready to carry through complaints against alleged incompetence or poor service into claims for damages.

There are two matters at issue in considering the public need for mandatory liability coverage for professionals:

- The first is the availability of funds for the settlement of claims for damages, and
- The second is the effect that a mandatory insurance requirement may have on the profession's self-regulation policies and activities regarding policing of competence and conduct.

The Committee considers it necessary that assurance be extended to the public that protection is available against the negligence, misconduct or incompetence of persons licenced as professionals in this Province. This assurance can be provided either in the form of insurance obtained from private insurance markets or by participation of the professional in a group self-insurance plan. In the latter case, the Committee believes, as previously stated in Chapter 12, that the Superintendent should have the authority under The Insurance Act to investigate, set up guidelines and report on the activities of any self-insurance mechanism providing funds for the payment of liability claims.

17.10 The Committee recommends that all those persons licenced to practice as professionals in this Province and acting on behalf of the public be required to show proof of errors and omissions insurance or proof of membership in a self-insurance mechanism which is registered with the Office of the Superintendent for the provision of liability coverage.

Included as professions to which this recommendation pertains are those which fall under the following statutes:

1. The Architects Act,
2. The Law Society Act,
3. The Notaries Act,
4. The Professional Engineers Act,
5. The Public Accountancy Act, and
6. The Medical Act.

Those members of these professions who are employed by organizations or firms outside the profession and who do not act on behalf of the public might be considered to be exempt from the insurance requirement. This may be a matter for the profession to determine.

It is evident that a mandatory insurance or group self-insurance requirement calls for coverage being extended to all professionals in public practice, including those who may not normally be able to obtain coverage from the private insurance market. This places an onus on the private insurance industry to guarantee the availability of errors and omissions coverage where the alternative of self-insurance is not available or is not chosen by the professional. Similarly, the requirement of guaranteeing availability to all members of the profession must also be assumed by the self-insurance programme. Neither the private insurer nor the self-insurance organization should become a “co-licensor” by selective rejection of risks.

The cost of coverage for those professionals most subject to claims will be passed on to the general membership of the profession. This may act as an incentive for the profession to undertake more effective self-regulation policies regarding competence and conduct, to monitor claims experience, to identify those members with a disproportionate percentage of claims and to develop loss control programmes of an educational nature. Such measures are clearly of public benefit as well as of benefit to the members of the profession through reduction in their liability insurance costs.

The choice to self-insure under a group plan should be one made by the professional group and not one forced on the profession by lack of availability of errors and omissions coverage.

- 17.11 The insurance industry should undertake to make available errors and omissions coverage to professionals at the *true* cost of this coverage based on experience in this Province. Accordingly, the insurance industry should undertake to make improvements in its statistical data base and underwriting procedures to service the market for errors and omissions coverage more completely and effectively than at present or in the past.

The Committee notes that consideration of the requirement for liability insurance for professional groups is being addressed by the Professional Organizations Committee, a ministerial committee of the Ministry of the Attorney General of Ontario formed to make recommendations on a variety of issues related to professional regulation.

- 17.12 The Committee encourages the insurance industry to participate in the public discussions of the Professional Organizations Committee regarding the availability of errors and omissions coverage for professionals and the problems associated with its provision.

D. SURETY BONDS

1. The Nature of Surety Bonds

Surety bonds are a guarantee form of insurance which offer protection to a third party and not to the applicant for bond coverage. Surety bonds can take many forms, but the most common type of surety bond is the contract

fulfillment guarantee in the construction industry. The contract bond issued to contractors is the subject of the Committee's consideration in this Part of the Report as a result of the representations brought to the Committee regarding difficulties in obtaining bonds by the Ontario General Contractors Association and the Mechanical Contractors Association of Ontario.

A contract bond guarantees that a construction project will be completed. If it is determined that the "bonded" firm cannot complete the work under contract, the surety company completes the project for the owners. The surety company has the right to collect back from the contractor all funds expended to complete the project. The resolution of any disputes over the funds spent on completion is then decided through the courts.

As the surety is able to look to the contractor for reimbursement of losses incurred, the rate charged by the surety is based on the expense and overhead to the surety company plus a margin for profit, but does not contain a provision for loss to the extent that is built into the normal insurance premium. For this reason the premium rate for a surety bond does not normally vary over time, except to reflect rising expense costs or extensive defaults by contractors who are unable to reimburse the surety company for expenditures to complete a project. This latter situation is avoided by restricted writing of surety bonds.

The surety bond traditionally has acted to protect the owner of a bond. It therefore identifies itself with the financial interests of the owner and his interest in seeing that a project is completed. The owner is generally not concerned about the lack of availability in the surety bond market, unless this lack of availability substantially restricts competition to "high-bid" contractors.

From the point of view of the surety company, it is essential that losses be minimized by underwriting bonds only for contractors who are in a position to carry out their contracts. Therefore surety bonding is essentially a risk selection or pre-qualification process, rather than an insurance process.

On the other side, the contractor initially tends to view the premium for a bond as similar to a premium for homeowner's insurance and, therefore, may become angered when he is refused a bond. He then sees the bond as a "licencing" requirement designed to restrict his access to certain construction business or bar him from certain jobs. The contractor's main concern is with availability, whereas traditional insurance solutions to availability are not applicable in the surety bond situation.

2. Current Problems Regarding Surety Bonding in the Ontario Construction Industry

Witnesses before the Committee pointed to the following problems ap-

parent with the use and availability of surety bonds in the Ontario construction market:

- Increasing difficulty is said to be experienced in the construction industry in obtaining bonding, by both large, well funded contractors and smaller, financially weaker contractors. The current uncertain economic situation in Canada is said to have heightened the scrutiny by surety companies of bond applicants' business and led to a greater incidence of refusal of bonds. Furthermore, poor underwriting experience in the United States is said to have created restrictions in Canadian markets as many surety companies in this country are owned by U.S. surety firms and influenced by their underwriting experience outside Canada.
- Concern has been expressed that the insurance industry has not been sufficiently responsive to the needs of the small contractor. Servicing the small contractor on occasional contracts may not generate enough income to motivate surety industry interest.
- Surety companies ask for indemnity agreements and personal guarantees or other pledges of personal property from principals of contracting firms. This practice is of concern to many contractors.
- Surety companies do not disclose their bonding criteria and seldom disclose the reason why a bond may have been refused.
- The surety industry is accused of not being sufficiently responsive to the peculiarities of the construction industry. For example, it is suggested that the working capital requirements used as criteria for bonding are inappropriate or restrictive as many contractors are able to operate with a small working capital base.
- The surety industry is also accused of being inflexible in the bonding process. As an alternative to rigid initial criteria for bonding, it has been suggested that the surety industry monitor construction projects. When project problems are spotted, monitoring might be supplemented by restrictions placed on asset transfer, shareholder payout and the like, to ensure the successful completion of the project by the contractor.
- There appears to be a lack of understanding of what bonds are by architects, engineers and the buyers of construction.

The Committee views the surety industry as providing a number of services to the construction industry rather than insurance in the ordinary sense: these services include pre-qualification of contractors and completion of a contract in the event of default by a contractor. The Committee's impression is that the industry places perhaps too great an emphasis on the former aspect of service and too little emphasis on the latter. It has been pointed out to the Committee that the surety industry is sometimes slow in taking over the responsibility to complete a project but may be too conscientious in rejecting bonding applications from the small contractors.

3. Directions for Improvement

It is not the Committee's view that the surety industry should be asked to absorb the problems of the construction market place into the existing system of suretyship. However, it is apparent to the Committee that the existence and unquestioning application of the surety bonding process contributes to problems of competition and entry into the construction trade. The expectation by owners that the contractors they hire must obtain a surety company as a co-signer on all contracts, places the surety industry in the position of receiving applications for bonding from a wider universe of candidates than they can service while adhering to the surety principle of "no losses".

This owner expectation leads to a market gap wherein some portion of the applicants for bonds are refused bonding. The size and nature of this gap determines whether alternatives to bonding by the surety industry must be developed to provide access to construction jobs for applicants.

It is the Committee's impression that the time may already have been reached when it is necessary to search for alternatives to the surety bonding process, unless the surety industry is able to develop means to serve a wider range of applicants for bonds as well as keep up with owner's requirements.

The Committee has considered several suggestions brought before it by witnesses on ways to improve the provision of surety bonds as contract guarantees in the construction market. The suggestions and the Committee's conclusions which follow below require considerable study as there are no simple solutions to a problem that requires innovative thinking and new approaches.

17.13 The Committee sees the opportunity for the surety industry to become more responsive to the situation of contractors, as well as to that of owners, by:

- Defining clear criteria by which contractors will be judged in applying for a bond;
- Developing within the surety industry a better understanding of local construction markets to ensure that the criteria for bonding are flexible in that they respond to local construction trade conditions;
- Setting up a more permanent association between the surety and the small contractor. The contractor who does not often apply for a bond could maintain this association by payment of a retainer fee to the surety;
- Developing "umbrella" bonds to reduce the proliferation and duplication of bonds issued to the various contractors working on the same construction job.

The Committee encourages the surety industry to adopt these approaches to the bonding process as part of a greater effort which must be directed by the industry in the immediate future to service a wider range of bonding applicants. It is the Committee's view that if the surety industry fails to serve this wider market, other forms of contract guarantees will in time be developed in the construction field to the detriment of the surety business.

- 17.14 At the same time, the Committee sees the need *within the construction industry* to review the bonding process. Owners, architects, contractors and others must recognize the need to cooperate in developing alternatives to bonding or finding ways to ease bonding requirements. While it is unlikely and unrealistic for municipalities or other public bodies to dispense with the requirements of low bid contracting supported by a bond in tenders on publicly funded projects, other alternatives may be of benefit to both owners and contractors in the private construction industry.
- 17.15 The Committee also sees the opportunity for contractors to provide guarantees to owners through a self-bonding mechanism. Any review of the bonding process should include discussion of the acceptability to owners of a self-bonding system, wherein contractors group together to provide for guarantees on completion of contracts. The Superintendent is encouraged to take a participatory role in reviewing any proposals for self-insurance as well as ensuring that no regulatory impediments are placed in the way of self-insurance.

E. SPECIALTY LINES—MARINE

Marine insurance contracts are covered by The Marine Insurance Act. This Act provides a code of principles with respect to the business of marine insurance and reflects to some extent the strongly international nature of this class of business. The Superintendent administers matters pertinent to this Act.

The Committee has not engaged in a thorough review of the marine insurance industry but has relied on the detailed study of industry characteristics published in April 1978 by the Canadian Transport Commission under the title, *The Marine Insurance Industry in Canada*.

The Committee notes that marine insurance is not subject to many of the statutory, solvency and taxation provisions applied to other classes of general insurance. The Canadian Transport Commission study points out that:

“the Canadian marine insurance activities of the branch offices of foreign-incorporated insurance companies are unregulated at the federal level. Technically, the marine insurance operations of Canadian-incorporated companies are also unregulated by the Federal Depart-

ment of Insurance, however, as marine business is not separated from other classes of insurance, it generally conforms to the provisions of the Canadian and British Insurance Companies Act. In addition, while Canadian-incorporated insurance companies are subject to the Income Tax Act with respect to their marine earnings in Canada, the marine earnings of foreign-incorporated companies are tax exempt. Marine insurance effected outside Canada with unlicensed companies is also exempted from the excise tax normally payable on the amount of premiums written. At the provincial level, it appears that essentially only the formality of licensing is required, except in the provinces of Quebec and Alberta where marine insurance is subject to the general application of the provincial Insurance Acts. In addition, the provincial premium tax levied on other classes of property and casualty insurance in all provinces does not apply to marine insurance."

- 17.16 The Committee requests the Superintendent to review The Marine Insurance Act to ensure that the principles of industry responsibility and government responsibility developed by the Committee in regard to The Insurance Act be applied where relevant to marine insurance contracts.

Specifically, the Superintendent should direct his attention to the necessity and advisability of subjecting marine insurance to the general application of The Insurance Act in this Province.

PART X

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

CHAPTER 18

Summary of Conclusions and Recommendations

The following is a summary of the conclusions and recommendations that the Committee has reached, as set out in this Report. Part I and Part II, which provide necessary background information to the Committee's more specific considerations in the remainder of the Report, are not summarized here.

PART III: OBSERVATIONS ON THE GENERAL INSURANCE SYSTEM

Chapter 7—The General Insurance Industry and Government Supervision

- 7.1 The Committee concludes unanimously that there is a continuing need for a government presence in the general insurance industry. Government supervision of the insurance system is necessary to protect the public interest both because of the nature of the risk environment affecting the public and because of the essential yet intangible nature of the insurance product itself.
- 7.2 Three key guidelines should define the nature of the government's presence:
 - a) The government presence in the insurance industry should devote explicit attention to the consumer's needs.
 - b) The government presence should not unduly burden the private insurance industry by over-regulation.
 - c) The private insurance industry must demonstrate its commitment to providing protection against risks at a reasonable price to all citizens of the Province of Ontario.
- 7.3 In identifying the need for a rationalization of the government's presence in monitoring and fostering industry efforts to serve the public interest, it is not the intent of the Committee that the process of rationalization should entail any immediate restructuring of the Office of the Superintendent. Rather, the Committee's recommendations in regard to the Office should be considered in the context of refining the *joint efforts* of the industry and the Superintendent's Office with the intent that there would be no additional expenditure of public funds and no additional staff requirements.
- 7.4 The Committee concludes that new directions toward satisfying the public that their interests are being met, must be formally recognized in insurance regulation in the Province of Ontario. In this regard, the

Committee has considered a regulatory system which would monitor the effectiveness of competition in insurance markets and, in the Second Report, found this system to be the form of automobile insurance regulation best suited to the present market conditions in the Province in Ontario. As a method of regulation, it relies on the existence of a competitive market as the best means of ensuring an insurance system that serves the public interest. It requires that the market place be monitored on a formal, ongoing basis to ensure that it retains its competitive characteristics.

- 7.5 The Committee concludes that the monitoring of the effectiveness of competition is equally applicable and appropriate as a regulatory mode in other than automobile fields of general insurance.
- 7.6 The Committee recommends that the Superintendent develop and implement in Ontario a formal system of monitoring the effectiveness of competition to include both the automobile and the property and casualty sectors of the general insurance industry.
- 7.7 The Committee suggests that the monitoring system developed by the National Association of Insurance Commissioners in the United States provides a suitable starting point for development of a monitoring system suited to the market environment in the Province of Ontario.

Specifically, the Committee encourages the Superintendent to implement a formal data gathering and reporting system corresponding to the following tests and indicators:

1. Performance Indicators

- General insurance profitability, by line for all lines, country-wide.
- Comparison of inter-industry rates of return.
- Operating profit by line of general insurance for Ontario.
- Variation in rates.
- Independence in pricing.
- Price changes per company per year.

2. Structural Indicators:

- Concentration ratios by line.
- Market share ranking by line.
- Entries and exits.

3. Conduct Tests

- 7.8 The Committee recommends that the Superintendent submit an annual report to the Legislature and public in Ontario, which is to include a review of the competitive indicators monitored by his Office and commentary on the analyses related to the statistical information.

- 7.9 The Committee recommends that amendments, where necessary or appropriate, be made to The Insurance Act to provide the Superintendent of Insurance with the authority to request such information and to publish such data and analyses as are needed for the system of monitoring the effectiveness of competition.
- 7.10 The Committee suggests that the Superintendent and the Ministry of Consumer and Commercial Relations give consideration to the undertaking of initiatives which would foster or stimulate competition in the general insurance industry in this Province. The annual publication of the results of the Superintendent's monitoring activity would be a starting point.
- 7.11 The Committee recommends that Sections 365 and 367 of the Insurance Act be reviewed, updated and proclaimed. The Superintendent's authority over rate practices not in the public interest should be defined explicitly in legislation. It is not the intent of the Committee that proclamation of these sections would result in a system of rigid rate approval or regulation by the Superintendent. Rather the authority in these sections should be exercised primarily in situations identified as non-competitive by the competition monitoring system or in situations brought to the Superintendent's attention through complaints or other investigative activity.
- 7.12 In the Committee's opinion, a greater emphasis in the future on the monitoring and fostering of competition will achieve a better balance between financial stability and the other public interest objectives inherent in the government's presence. As a further measure intended to improve this balance, the Committee recommends that further review be undertaken of the solvency monitoring process carried out by *both* the Federal and Provincial Superintendents.
- 7.13 In regard to the solvency rules applied both by the Federal Superintendent and by the Superintendent in Ontario, the Committee recommends that in general the rigidity of the current rules and their application be relaxed while still meeting the consumer's needs for a reliable product. In the Committee's opinion, the present rules appear to be unnecessarily conservative in the broadest context of protecting the *overall* interest of the public. Their universal application to all insurers on a uniform, rigid basis may limit the development of the more efficient companies and mask the inefficiencies of others.
- 7.14 The Committee suggests that the prime thrust of the solvency and liquidity requirements should be to ensure that there are sufficient "admitted assets" maintained by an insurer to meet its "adjusted liabilities" as appropriately defined. In regard to other measures of solvency and liquidity, the Committee recommends that they be made more flexible to individual company circumstances.

- 7.15 In order to assist the general insurance industry in attracting new capital, the Committee considers it appropriate for the Superintendent to re-examine the dividend restriction rule. Increased dividend opportunities could stimulate investment in insurance companies, thereby affording more equity required for structured and stable growth.
- 7.16 As further encouragement for increased investment in the insurance industry, the Committee recommends to the Superintendent that he re-examine the advantages and consequences of allowing wider use of alternative forms of investment in the industry such as debentures and preferred shares, so long as the first legal obligation of insurers is maintained to be the payment of claims.
- 7.17 To accomplish the objectives set out above, it does not appear appropriate to the Committee that the solvency measurements as a whole should be rigidly defined or set out in legislation. The Committee however encourages the Superintendent, after review of the solvency monitoring process, to give consideration to recommending the legislation of a prime rule or limited number of rules which are of a uniform or universally applicable nature.
- 7.18 To supplement the primary thrust of solvency regulation, while ensuring flexibility in the system, the Committee sees merit in the implementation of a solvency monitoring system made up of a series of measures and indicators which would act as an "early warning system". Each company would be required to submit, at least annually and more frequently as required by the Superintendent, information concerning its operations. Data submitted by each insurer should be assessed not on the basis of specific ratios alone but, as well, in the context of the history, experience, management competence, book of business and so on of the individual company involved. This information would permit the Superintendent to review each company's operation and the trends indicated on its development in order to judge on a more objective, meaningful basis the appropriateness of the restrictions or guidelines to be imposed on an individual company to improve its operations.
- 7.19 Given the Committee's conclusions regarding relaxation of the solvency requirements, the Committee considered the need for establishing a guarantee fund operated by the general insurance industry in this Province but agreed that its establishment did not appear to be needed at the present time. The Committee suggests, however, that the Office of the Superintendent continually re-examine this need in light of any changes in legislation, its own activities or industry performance in Ontario.

PART IV: CAPACITY

Chapter 8—Capacity: The Ability of the General Insurance Industry to Underwrite All Risks

- 8.1 The Committee is generally satisfied that present market demand for general insurance coverage is being met by the industry in this Province. With the exception of market gaps in some commercial insurance areas or in certain territorial areas, the insurance-buying public has little or no difficulty in obtaining coverage from insurers in this Province. The Committee is pleased to see that problems of availability which existed in the past in some lines of insurance or in some areas of the Province have generally been resolved.
- 8.2 For the future, the Committee maintains that the government interest in the capability of the private insurance industry in this Province to handle the market demand for insurance coverage must extend beyond the financial capacity of insurance companies to underwrite risks. The government interest should be directed at a broader definition of capacity, one which encompasses other, equally important matters that determine *the ability to underwrite risks*. These further determinants of capacity include:
- A satisfactory operating environment which encourages industry growth;
 - Efficient management in the industry as a means of encouraging consumers to make use of domestic capacity; and
 - The use of mechanisms which maximize the utilization of the total capacity of the industry in Ontario.
- 8.3 To establish a satisfactory operating environment for industry growth, the Committee has already considered and recommended in Chapter 7 relaxation of the present solvency rules to permit companies capable of writing new business to expand their activity. The Committee has encouraged the Superintendent to examine the following options:
- (a) Greater flexibility in the application of the solvency rules as opposed to the rigidity and uniformity of measurements presently applied.
 - (b) A shift in the thrust of solvency regulation to an asset to liability test, to be supplemented by periodic monitoring of other ratios on an "early warning" basis.

Relaxation of the solvency regulation process to suit the individual circumstances of insurers will provide a more suitable environment for capacity expansion.

- 8.4 The Committee recognizes the need for industry profitability as a condition for growth in the insurance industry. Furthermore, it believes that its recommendations in favour of the monitoring of competition as a regulatory mode for the general insurance industry combined with relaxation of solvency regulation, will provide the appropriate environment for a reasonable and competitive level of profit.
- 8.5 The insurance industry, in carrying out its responsibility to provide protection at a reasonable price to all citizens in this Province, must demonstrate efficiency in its management. If the industry is not efficient in its operations, the consumer will feel that he is paying too much for his coverage as a contribution toward operating costs and will seek lower cost insurance elsewhere.
- 8.6 Efficiency in management of insurance operations must extend to investment of policyholder funds. The Committee continues to believe that the general insurance industry's investment policies are too conservative. The Committee expects the industry to make more efficient use of its investment funds as a means of reducing the premium burden on the insurance buyer in this Province.
- 8.7 The Committee also recommends that Section 383 of the Insurance Act be reviewed to examine the current appropriateness of the various investment instruments defined in this Section of the Act. The Committee is concerned in particular that the list of nations, specified in regard to investment in government bonds or other forms of government financing, is inappropriate and should be reviewed by the Minister.
- 8.8 The Committee is concerned that the industry has tended to rely on traditional operating and marketing methods and that progress in improving efficiency has only recently begun to be apparent. While the Committee believes that it is the responsibility of the industry to look after its own interests by improving efficiency, it suggests there is a potential for improvement that has been partially recognized with respect to automobile insurance, that must be extended further and should include all lines of general insurance.
- 8.9 As a step toward a more efficient and equitable insurance system, other forms of compensation should be considered by the industry as alternatives to the current commission rate structure applied by agency writers. The current commission structure, based on an across-the-board fixed percentage of the premium, is inequitable to policyholders in different rating classes, particularly to those who pay a higher pure premium. In most cases, the higher pure premium is unrelated to any increase in marketing or policy processing effort on the part of the sales intermediary, yet the policyholder is assessed a higher commission cost charge.

- 8.10 Both insurance companies and the agency system should undertake further and continual measures to improve efficiency in marketing and processing the insurance product to ensure that productivity keeps pace with market demand. The insurance industry is encouraged to examine new ways of marketing the insurance product. In addition, the insurance product, application and other forms should be reviewed with a view to their simplification and standardization to assist in streamlining marketing efforts and reducing processing costs.
- 8.11 It is the Committee's expectation that the somewhat higher costs of underwriting and processing personal lines policies relative to these same costs in automobile lines, can be reduced by simplifying the collection of underwriting information and streamlining the related administrative tasks, such as issuing of policies, policy amendments, communication, filing, and so on. The Committee generally encourages the general insurance industry to give more attention to improvements in policy processing systems and procedures and the greater application of data processing technology. Underwriting and policy processing are areas in which the industry, through the use of computerization, should be able to make significant future strides in data capture and assault on expenses.
- 8.12 The Committee's primary concern in the area of claims settlement is related to the direct costs of legal, independent and staff adjusting, appraisal services and related procedures which are charged directly to the claim file and accumulated as part of claims incurred. The Committee has been unable to obtain any meaningful statistics on these costs in property and casualty lines of insurance. Similarly, in its study into automobile insurance, only a rough estimate of claims expenses could be derived, based on periodic analyses by the industry.

In the automobile insurance field, it was estimated that 11¢ out of every \$1.00 of automobile premium earned by the industry was charged to the claims file while the total expense allocated to claims adjusting amounted to 15.1¢. The Committee expects that costs in property and casualty lines are higher and, therefore, considerable attention must be given to control over these costs.

- 8.13 The Committee recommends that insurers cooperate with the Superintendent's Office in providing better information on claims costs in all lines of general insurance. The Committee recommends that insurance companies be encouraged to disclose their costs of adjusting claims either through the Insurance Bureau of Canada's statistical or expense allocation reporting systems or through the Superintendent's Office.
- 8.14 The Committee further encourages the industry in its continuing efforts to reduce adjusting costs through such measures as telephone adjusting and more efficient internal claims processing procedures.

- 8.15 Efficient management in the insurance industry must also extend to cost containment through control over claims settlements and through loss prevention services. The Committee has heard comments from several witnesses regarding over-generous settlements in personal property claims. The Committee urges the industry to undertake better measures for control of costs, particularly in regard to the smaller, more frequent claims.
- 8.16 The Committee encourages development in the general insurance industry of group merchandising initiatives, as forms of selling that reduce costs, so long as the group plans are carried out on sound bases that do not discriminate unfairly by “creaming” the market.
- 8.17 The Committee recommends that the Superintendent and the industry reconsider the necessity for differentiating between automobile and other general insurance group plans. At the present time, automobile group insurance plans only are subject to the limiting provisions of Section 363 of The Insurance Act and to guidelines set out by the Superintendent in 1969.

In general, it is recommended that consideration be given to the removal of restrictions on group merchandising plans as set out in the Act and in the guidelines, if study by the Office of the Superintendent can define a set of more relevant guidelines that protect the public interest but do not restrict non-traditional approaches to marketing insurance.

- 8.18 The Committee earlier expressed its belief that, so long as the general insurance industry remains in the private sector, it must give due recognition to the responsibility of providing protection against insurable risks at a “reasonable price to *all* citizens” of the Province of Ontario wishing insurance coverage. This responsibility requires the industry to make efficient use of total industry capacity so that there are no gaps of availability.
- 8.19 The capability of the industry to underwrite risks and remain solvent and profitable depends on its ability to predict losses. The following factors are of particular importance in regard to the underwriting function.
- (a) The Committee draws specific attention to the need for collective, uniform gathering of statistics on loss experience to promote a reliable base for informed loss prediction and underwriting. All insurers should consider it to be their responsibility to contribute to and support industry-wide statistical plans in both personal and commercial lines of general insurance and to support improvements in these plans towards more meaningful and useful informa-

tion. The Committee expects that contribution of such data would not be tied to membership in the industry body which acts as the agent for collecting and analyzing this information.

- (b) Other collective efforts, in standardization of products or procedures to simplify underwriting, in risk inspection, research and in technical services, should also be supported widely by all insurance companies without the need for government regulations in this regard.
- (c) In regard to the skill of underwriters and actuarial staff in evaluating and pricing future risk potentials, the Committee emphasizes the need for the recruitment, hiring and training of qualified underwriters familiar with the local risk environment and the protection expectations of consumers. Wherever there is a lack of qualified underwriting or actuarial staff, the industry in Ontario should undertake to educate and train candidates for this function.

8.20 The Committee recommends that, if required in the future, the Superintendent advise the encouragement, through reduced taxation or other incentives, of cooperative groups or conventional insurers in supplying otherwise underserved markets, in particular circumstances wherein persistent gaps of availability are identified.

8.21 In order to encourage a proliferation of various types of companies serving the consumer, the Committee supports the Superintendent in his discussions towards relaxing the legislated restrictions imposed on the business of farm mutuals.

8.22 At the same time, the Committee recommends that the growth of farm mutuals into non-agricultural areas of business be treated as a separate book of business and be subject to the same taxes and other conditions imposed on insurers in the conventional market. In regard to the matter of taxes, it may be necessary for the Superintendent to request the federal government to re-examine its income tax rules to ensure that special privileges do not apply to farm mutuals or other insurers who have a substantial amount of business in other than farm risks.

8.23 In considering the relaxation of legislated restrictions on farm mutuals, there also appears to be an opportunity for the reinsurance market to be opened up for the Farm Mutual Reinsurance Plan, to increase its ability to write both farm and any new business farm mutuals may be allowed to undertake. The Committee views this measure as desirable so long as any reinsurance assumed on non-farm risks is not subject to any advantage not provided to other reinsurers in this Province.

8.24 In considering the relaxation of legislated restrictions on farm mutu-

als, the Committee recommends that the Superintendent also give attention to reviewing the financial or solvency restrictions on farm mutuals. The Committee has recommended the review and relaxation of the solvency rules for all general insurers according to their particular circumstances. This same concept implies that the present rules for farm mutuals might continue to be applied, with some flexibility to permit the more efficient or financially stronger farm mutual companies to expand their business.

- 8.25 To meet its responsibilities regarding effective use of industry capacity, the Committee encourages the industry:
- (a) To seek out the most efficient mechanisms for utilization of capacity. These will likely differ in various market circumstances;
 - (b) To seek new or innovative methods of bringing together buyers and sellers of insurance;
 - (c) To demonstrate a reasonably representative industry presence throughout the Province; and
 - (d) To avoid mechanisms which charge rates for risks rejected by the voluntary market on an entirely different rate structure from that in the voluntary market.

The industry, by following these guidelines, would be demonstrating its willingness to act in the best public interest.

- 8.26 In keeping with the above guidelines, the industry is encouraged to explore the concept of an insurance exchange that brings together insureds, or their brokers, with skilled underwriters and insurers. Such a concept has come to the Committee's attention, in regard to the recently approved New York Insurance Exchange. Its primary application would appear to be in the area of hard-to-insure risks.

- 8.27 The Committee, foremost, expects to see a "take-all-comers" *attitude* on the part of all licenced insurers in this Province in respect of all coverages in which they do business. The "take-all-comers" principle requires each insurance company to accept all applicants, using its own rate manual to quote premiums for each category of business it writes. This principle relies on the ability of each company to pool any business it does not wish to retain through an appropriate reinsurance mechanism. From the consumer's viewpoint, this approach provides the insured with direct access to the insurer of his choice. Furthermore, it is likely a more efficient marketing approach in many circumstances than one which relies on an intermediary to search the market for a placement.

PART V: AVAILABILITY, COVERAGE AND COST

Chapter 9—Availability in Personal Lines

9.1 Among the general insurance industry's primary responsibilities is the function of providing insurance for personal residential and liability risks to all residents of Ontario. The Committee maintains that, for every residential risk in Ontario, the insurance industry should be able to establish a reasonable rate commensurate with the risk involved and hence offer coverage on all risks.

The Committee once again emphasizes with specific reference to personal lines that the insurance industry should endeavour to meet its responsibility to provide coverage, first and for the most part, through a "take-all-comers" attitude on the part of individual insurers.

The Committee finds this approach to be the most efficient method of bringing together the buyers and sellers of personal lines of insurance and it provides the consumer with direct access to the insurer of his choice. The industry should at the same time look at collective efforts at pooling substandard risks which individual insurers do not wish to keep on their own account.

9.2 The Committee encourages the industry to cooperate in innovative, contingency plans for ensuring availability. An example has come to the Committee's attention concerning a pilot programme initiated in the State of Connecticut.

The Connecticut pilot programme is a voluntary, cooperative effort of insurance companies, agents and the Department of Insurance to make insurance more readily available to homeowners through a toll-free, state-wide inquiry and placement service. Participating agents and companies make every effort to fulfil consumer's needs and no property is declined coverage except for good cause and valid reasons. Any company rejection of coverage is subject to a review by a management committee and the Department of Insurance. The Committee sees merit in such a programme even in times when there are no widespread problems with availability.

9.3 Should the industry fail to provide availability, the Committee has considered the need for government measures to ensure availability in personal lines, including the establishment of a government-sponsored residual market mechanism and legislation to require insurers to "take-all-comers" or to sell in all parts of the Province. The Committee views direct government measures as a last resort and not necessary in the current market situation.

Chapter 10—Coverage in Personal Lines

- 10.1 In considering consumer expectations and needs regarding coverage on the dwelling, the Committee concludes that *full replacement cost coverage* is a concept which the insurance industry as a whole should undertake to study and to offer without restriction in all homeowner's policies.

Under this coverage, each policyholder would be insured to full replacement cost value on the dwelling, including debris removal, rather than to the amount of insurance coverage carried. An amount of insurance would be specified for premium setting purposes only.

- 10.2 Many insurance companies at present do not offer the option of replacement cost coverage on contents. The Committee encourages the insurance industry as a whole to offer replacement cost coverage on contents to any insured wishing to obtain this option. In this way, the Committee feels that the industry will be responding more fully to consumer expectations in regard to recovery for contents.
- 10.3 The Committee sees merit in the introduction by the industry of a standard *core* coverage to assist consumers in comparative shopping. The Committee encourages the industry to develop and offer without restriction a *core* coverage that meets the coverage expectations of the majority of consumers.

The Committee therefore suggests that the *core* coverage might be defined as:

- Coverage on the *dwelling* against fire and all major perils currently provided for in the majority of homeowner's policies; and
- Full replacement cost coverage on the *dwelling*, with no upper limit on recovery or alternatively a higher upper limit, say \$250,000.

Further coverages, related to protection against liability or contents losses could as well be incorporated into the *core*, if the industry were satisfied that the formulation of these coverages met the needs of a majority of policyholders.

- 10.4 The Committee regards the choice of coinsurance at the top levels of coverage to be a false economy for the average consumer. The additional premium cost to achieve "insurance to value" is normally minimal, whereas the cost to the policyholder in sharing damages in a major loss can be substantial. A better solution for providing savings in premiums would be to provide a choice of deductibles on coverage to suit the pocketbooks of consumers.
- 10.5 The Committee believes that it is desirable to have an availability of a choice of amounts of coverage for contents. Such choice should as

well be extended to include increased values for special items such as jewellery, furs, coin or other collections and so on, or to provide for replacement cost coverage, without the need for separate endorsement or declaration. By being given a choice of coverage limits on contents, the consumer may in fact consider more carefully the extent to which his investment in contents is put at risk. The consumer will then insure accordingly.

- 10.6 In general, the Committee supports the availability of greater choice in coverages, including the “unbundling” of package policies to permit the consumer to exercise a greater choice among the component coverages in the policy package. The Committee encourages the industry to provide this wider choice, while assisting the consumer to shop by means of better information provided by the sales intermediary and by the development of a *core* coverage.

Chapter 11—Cost in Personal Lines

- 11.1 To protect the insured in the event of a major loss, the Committee has previously in this Report encouraged the insurance industry to offer full replacement cost coverage in all homeowner’s policies as the basis for recovery of damages to the dwelling. This concept is of further value in alleviating the problem of overinsurance and making the insurance product more affordable. Accordingly, the Committee endorses the concept of a guarantee in the policy for full replacement cost coverage, including debris removal, to be provided whenever the policyholder insures to the value calculated according to a cost evaluation process approved by his insurance company. The Committee strongly encourages all insurers to provide this guarantee in their policies and encourages the Insurance Bureau of Canada to set this matter as a guideline for its members to follow.
- 11.2 An important aspect of the cost of insurance is the calculation of the insurable value of the home. The Committee discourages individual companies from calculating this component of the premium base on considerations which more rightly belong in the calculation of the rate. In the Committee’s view, the calculation of insurable values should be an objective process, based on a relatively well defined set of material and labour cost inputs.
- 11.3 The Committee therefore encourages the general insurance industry to develop and apply consistently a uniform cost evaluation procedure for determining the insurable value of properties and the periodic inflationary factors used to update the calculation of insurable values.

At the present time, insurable values derived for premium setting purposes vary among individual insurers. This variability con-

tributes to some confusion on the part of the consumer in the process of comparative shopping.

- 11.4 To cope with the bulk of complaints regarding premium costs, the Committee repeats its encouragement to the insurance industry to educate the public to greater use of deductibles and to market this concept actively in personal lines. In so doing, the cost of insurance can be lowered for the individual consumer and for the insurance system as a whole, with the elimination of minor claims.
- 11.5 Furthermore, the Committee reinforces its recommendations to the general insurance industry that it provide the consumer with a greater choice of coverage and/or service to allow him to reduce the cost of his insurance, if he so desires or if he so requires because of income constraints.
- 11.6 The Committee recommends that the insurance industry make available a "bare bones" or minimal coverage policy. While the demand for this coverage may not be extensive, the Committee feels that availability of this coverage is desirable for those consumers who either choose to take this coverage or are forced to take such coverage because of income constraints.

The Committee proposes that both the industry and the Superintendent of Insurance cooperate in formulating the "bare bones" policy since protection under this policy would be at a minimum.

- 11.7 The Committee concludes that the industry, in meeting its responsibilities to the Ontario consumer, should recognize the need for universal reporting of loss costs in personal lines. It encourages the few companies who at present do not report their loss statistics under the I.B.C. Brown Book or Personal Lines Statistical Plan to participate in this reporting Plan.
- 11.8 The Committee also encourages the industry to participate in a review of the classification system presently in use in the Brown Book to determine whether the classification system as traditionally developed is appropriate to current risk environment conditions. The Committee in particular recommends that the industry address the following questions:
 - Are a sufficient number of territories identified?
 - Does the town protection grade category truly identify loss costs as a result of firefighting standards or is it perhaps a surrogate measure of other community living standards, such as age of housing, extent of vandalism and crime and so on?
 - Can the system be made more understandable to the consumer?

- 11.9 The Committee also encourages the industry to review the classification system in the Brown Book to determine whether other factors can be identified for incorporation in the Plan as the basis for lower rates corresponding to individual efforts at hazard reduction. The industry should undertake to examine whether non-smoker discounts, smoke detector discounts or certain group discounts can be recognized as objective, uniform cells within the classification system.
- 11.10 The Committee suggests that statistics corresponding to a potential “discount” or “surcharge” factor be collected on a uniform basis for an appropriate period of time, to establish the validity of this factor as a rating cell. If analysis of the relevant statistics does not identify a lower cost of losses associated with the factor, then the Committee recommends that discounts or surcharges should be discontinued in practice. If the statistics prove a lower or higher cost relationship, then the factor affecting loss costs could be incorporated permanently into the statistical reporting system.
- 11.11 The Committee does not at this time believe it is necessary or desirable for the Superintendent to impose a rating classification system on the industry in personal lines of property and casualty insurance. Rather the Committee relies on the industry to establish a rating classification system that is *fair and suited to the current risk environment*. The Committee expects all insurers to determine their rates on the basis of this universal classification system and to incorporate any new factors that affect risk as described above.

Chapter 12—Availability, Coverage and Cost in Commercial Lines

- 12.1 In considering the availability of insurance for commercial organizations, the Committee recognizes that the commercial enterprise can, in certain cases, forego insurance and benefit from a programme of self-insurance. In general, the Committee views the commercial business community to be knowledgeable enough to engage in self-insurance in regard to protection of business property or protection against the consequences of business activities. More specifically, the Committee encourages greater use of deductibles as a practical means of reducing insurance cost to the commercial buyer and of reducing the overall burden of losses on the insurance system. The Committee encourages the insurance industry to actively promote this form of partial self-insurance.
- 12.2 The Committee notes the current interest in the formation of captive insurers. Although activity in this regard is limited among Ontario business firms, relative to the interest in the United States, the Committee recognizes that there are financial advantages to the location of captive insurers in certain offshore locations. The Committee views

the formation of captives in this Province as more desirable than location offshore in order to maintain the reserve and investment base of the captive in this Province. However, the Committee is not prepared to recommend specific incentives to attract captive formation in this Province and does not believe that such action is needed at the present time.

- 12.3 The Committee has given consideration to the need for supervision by the Superintendent of Insurance of certain self-insurance mechanisms, particularly in third-party liability situations. The Committee concludes that the Superintendent should have the authority under The Insurance Act to examine and report upon the adequacy of self-insurance plans covering the liability of business firms or professionals operating in this Province, should he find it necessary to do so in certain circumstances.
- 12.4 In view of the Committee's previous conclusions regarding the industry's responsibility for utilizing total capacity, the Committee once again in the context of commercial lines of insurance encourages the general insurance industry in:
- continued and better use of reinsurance;
 - more use of formal arrangements for risk-sharing in the difficult-to-underwrite lines related to:
 - risks with high insurable values;
 - non-conventional risks, so that unpredictable losses are spread throughout the insurance system;
 - liability situations particularly with high exposures;
 - better use of the brokerage function in bringing together insurers and customers;
 - introduction of a commercial "insurance exchange" for hard-to-place and high exposure risks, so that underwriters with special skills are readily accessible. An exchange is preferable to formal risk-sharing arrangements because it maintains competition.
- 12.5 The insurance industry should endeavour to seek out the more efficient methods of risk-sharing and not be satisfied with approaches that perhaps rely too heavily on the agent or broker to locate sufficient numbers of subscribers for a risk placement.

Therefore, the Committee once again emphasizes its encouragement to the industry that it meet its responsibilities with respect to availability in all lines by a "take-all-comers" attitude on the part of individual insurers, supported by collective efforts at pooling risks which individual insurers are unable to keep on their own account.

- 12.6 While the alternative of government participation in ensuring avail-

ability of certain “problem” coverages is not unknown, the Committee does not propose this alternative for Ontario.

The Committee believes that insurance can be made available for all “insurable” risks at a price that reflects the extent of risk. If the price is prohibitive then transfer of the responsibility for insurance to the government or ultimately to the taxpayer is not a solution to the problem of price. It is merely a spreading of the price among all taxpayers, rather than among those with direct interest in the risk.

The Committee maintains that it is the responsibility of the general insurance industry to find a way of underwriting all risks to the greatest extent practical.

- 12.7 The Insurance Bureau of Canada’s Commercial Lines Statistical Plan is the statistical data base currently utilized by the Insurers’ Advisory Organization and many individual insurers in their ratemaking. The Commercial Lines Statistical Plan is not sufficiently detailed or comprehensive to provide the most meaningful basis for objective rate-making. This concern is widely recognized by the insurance industry.

In general, the Committee encourages the industry to devote more attention on an immediate basis to the improvement of the Commercial Lines Statistical Plan and to the collection of more meaningful loss information in all lines of commercial coverage. Furthermore, the Committee urges all insurers to participate in responding to the I.B.C. Commercial Lines statistical reporting system, as demonstration of industry-wide commitment to developing an appropriate, cost-effective data base that will assist in the better pricing of the commercial insurance product.

- 12.8 It has been suggested that the “schedule” ratemaking process used for many commercial property risks is arbitrary and outdated, with insufficient credit or debit being given to loss reduction measures, new construction features and newly identified hazard factors. The Committee wishes to encourage the industry and the Insurers’ Advisory Organization in particular to review and develop improved methods of rating commercial property risks.
- 12.9 Of particular concern to the Committee is the influence of loss experience in other jurisdictions on the cost of certain liability coverages in this Province which are necessary to protect third parties. The Committee believes that this problem can be resolved through more comprehensive and detailed statistical information on the liability loss experience in this Province.

The Committee believes that a collective approach toward data gathering is particularly required in regard to liability risks in order to ensure that the information compiled is a reliable reflection of the Ontario risk environment.

PART VI: COMMUNICATIONS

Chapter 13—Communications

- 13.1 The Committee sees a vital need for an effective two-way channel of communication between the public at large and the insurance industry. There is today a growing demand among many consumers to learn more about the products they are purchasing. On the other side, there is the need for an informed insurance industry which will be responsive to the consumer's protection and service needs. The responsibility for developing an effective two-way communications process within the insurance system falls on the industry.
- 13.2 The Committee believes the insurance industry must be sensitive to consumer needs for a simplified policy. Wherever practical, the Committee recommends that the industry rewrite policy contracts in personal lines, in automobile lines, and in commercial lines of insurance to simplify their wording and format. In the case of the standard automobile policy, the industry would be required to cooperate with the Superintendent in the re-writing of the policy so that changes can be incorporated in The Insurance Act. The Committee previously made this recommendation in the First Report.
- 13.3 The Committee recommends that the re-writing of property and casualty policies be directed toward converting each policy to as simple and understandable a language as possible—that is, into “plain language”. The industry should devote immediate attention to the re-drafting of its personal lines policies and to the redrafting of the standard automobile policy as recommended in the First Report. “Plain language” policies should be made available to policyholders in Ontario in both English and French.
- 13.4 To satisfy the consumer's need to know about the insurance product, the Committee recommends that each policyholder be issued a copy of his policy on the first issuance of the policy and with every addition or deletion to his policy. The mere act of renewing should not necessitate the delivery of a further copy of the policy. The Committee recommends that delivery of the insurance policy to each insured be made mandatory in all lines of property and casualty insurance.
- 13.5 The Committee sees a need for further “plain language” communication through brief, illustrative and simply worded pamphlets or brochures which supplement the policy contract. The Committee urges insurers not to be satisfied that they have fulfilled their responsibility to inform simply by issuing the contract—especially in the personal lines of insurance.

The Committee recommends that a supplementary brochure be issued at the time of each renewal or change in the terms of the policy

and that, at a minimum, it provide the insured with the following information:

- a brief description or illustration of the details of the coverage being provided by the policy;
- the dollar or other applicable limits applied to the coverage or components of the coverage, including the provisions for deductibles;
- the basis of recovery, as actual cash value or replacement cost value or other, with an illustrative example;
- the list of subscribing insurers and their share of the risk in the case of a subscription policy;
- who to contact in the insurer's organization or in the agency office in regard to questions, complaints or claims;
- other necessary information, some of which will be indicated by the Committee later in this Report.

- 13.6 The Committee also encourages the insurance industry to develop and use a simplified, standardized format for its personal lines policies, wherein elements that are common throughout the industry are grouped in similar order or page sequence in the policies drawn up by individual insurers. A standardized format will assist consumers in identifying readily those elements that are common in all policies and those that differ by company or by policy. A similar standardization of format should be considered for commercial line contracts where possible.
- 13.7 The Committee recommends that the application forms in property and casualty lines be revised substantially into a form that assists in informing the consumer as well as assisting the insurer in obtaining underwriting information. The Committee encourages the general insurance industry to develop the application form as a communications tool, designed to assist the consumer in recognizing the coverage options available to him and in choosing among those options.
- 13.8 The Committee encourages the general insurance industry to develop and implement *standard* application forms in the personal lines of insurance and, where practical, for commercial lines and especially for those coverages applicable to small commercial risks. As well as a communications tool, the standard application form should also be designed as a means of collecting underwriting information on a uniform, consistent basis corresponding in each line of insurance to a risk classification system applied uniformly by all insurers marketing that line of insurance.

- 13.9 A full or abridged version of the application form should be delivered to the policyholder at the time of each renewal of the policy, requesting the policyholder to check off any change in his choice of coverage and verify the information on the form. No reply from the policyholder could be taken as an indication of no change desired in the coverage.
- 13.10 The Committee believes there is a need within the general insurance industry for a focal consumer information and complaint service that is accessible to all Ontario residents and businesses and is well-publicized so that every insurance consumer is aware of its existence. The Committee recommends the establishment of this service in the Province of Ontario.
- 13.11 The Committee further recommends that the costs of this service be borne by the general insurance industry and that the service be operated by the industry. In order to capture the cooperation of direct writers in this service, this consumer information service would best be established under the auspices of the Insurance Bureau of Canada.
- 13.12 The consumer information service could be linked with a province-wide risk placement service for personal lines as encouraged by the Committee in this Report.
- 13.13 Access to the consumer information service should be free and should be well-publicized throughout the Province. A telephone number providing access should be included on all application forms and on all explanatory brochures accompanying policies.
- 13.14 The Superintendent should exercise a supervisory role in regard to the industry-wide consumer information service. His foremost concern would be to ensure support by all insurers and by agents, brokers, adjusters and other industry groups to the extent deemed necessary.
- 13.15 The operation of the consumer information service should be tied in with the need for the Superintendent to be informed on a regular basis, either monthly, quarterly or annually, of complaints or problems experienced with individual insurers, agents or adjusters. As a result, the Superintendent can investigate and take appropriate action regarding activities against the public interest. Certain matters of information could also be taken into account by the Superintendent in his role of monitoring of the industry.
- 13.16 Enquiries and complaints to the consumer information service should be recorded and analyzed as a means of identifying areas for industry improvement in performance and in communication. The Superintendent as part of his supervisory activity, should be required to issue

annually a brief report containing the statistics derived from analyses of the enquiries and complaints to the consumer information service.

- 13.17 In regard to the public reporting of complaint matters by the Superintendent, the Committee intends that the Superintendent would not only publish information on the types of complaints that arise against the insurance industry, but also that he would publish the names of individual insurers, agents, brokers, adjusters and so on with over ten complaints in a reporting year period.

In so doing, the Superintendent should investigate at least some portion of the complaints recorded by the industry-operated consumer information service or otherwise directed to his Office, to determine which are legitimate, not necessarily in terms of an illegal act, but also in terms of inconvenience or frustration to the consumer. In these investigations, the insurance industry will have been given the opportunity to refute complaints. Those still apparent as legitimate complaints should form part of the Superintendent's regular reports. Any rough justice to individual industry participants should be made up by the increased efforts of the industry to reduce complaints. Accordingly, publication of complaints will serve the public interest.

- 13.18 The Committee sees an informational requirement related to the purchase of insurance incidental to other purchases:

- That the cost of insurance be separated from the cost of the other goods and services bought and be so identified clearly; and
- That the consumer be made aware in a clear, written format that he has the option of purchasing or not purchasing insurance from a source other than the seller of a good or service.

The Committee recommends that the Superintendent ensure that all licenced insurers offering insurance products through the sellers of other goods and services be made responsible for making certain that their products are sold in accordance with the above informational requirements.

- 13.19 The Committee recommends that the Superintendent take on a more active communications and reporting role towards the insuring public.

The Committee is anxious to see the Superintendent assume a more aggressive position in this regard while at the same time developing the details of his role in the monitoring of competition as recommended in Part III of this Report. In this context, the Superintendent should engage in the analyses and reporting of complaints

directed to the consumer information service as recommended earlier in this Part of the Report. From time to time, in response to identified problems in the insurance industry, the Superintendent should also investigate and prepare public reports dealing with specific problem areas.

- 13.20 The Committee recommends to the Minister that, as a minimum, Section 90 of the Insurance Act be amended as appropriate to permit the Superintendent to request information and publish reports pertaining to the monitoring of the effectiveness of competition and to the matter of public disclosure of complaint statistics.

PART VII: QUALIFICATIONS AND CONDUCT

Chapter 14—Qualifications in the General Insurance Industry

- 14.1 In general, it is the Committee's observation that an insurance industry which devotes greater attention on a voluntary basis to the improvement of qualifications will more readily demonstrate competence and will meet the Committee's objectives of a better satisfied consumer and a better level of service. The Committee generally encourages the general insurance industry to do much more in educating and training its personnel.
- 14.2 Greater support should be given to the activities of the Insurance Institute of Ontario by insurance companies and by agents, brokers and adjusters. At the least, this support should take the form of greater encouragement to employees and to fellow participants in the industry to take part in the formal courses, seminar programmes and specialty courses of the Institute. In particular those employees in contact with the public should be encouraged strongly to take part in educational programmes.
- 14.3 The Insurance Institute of Ontario is to be encouraged in its updating of course materials, in its programme of specialty courses and seminars and in its expansion of programmes in local communities. The facilities of the Insurance Institute of Ontario might also be considered for purposes of consumer education and for the qualification of agents, brokers and adjusters as outlined later in this chapter.
- 14.4 Insurance companies are urged to undertake formal training programmes and other educational initiatives, such as seminars and written materials, directed both at internal personnel and at outside agents and adjusters to acquaint them with improved systems and procedures in underwriting, policy processing and claims handling and to update their knowledge in the areas of insurance policy changes and changes in government policy and regulations.
- 14.5 The Committee repeats its previous conclusion regarding the need for

the recruitment, hiring and training of qualified underwriters familiar with the local risk environment and the protection expectations of consumers. The industry in Ontario should also undertake to educate and train personnel wherever there is a lack of qualified staff at any level. Appropriate educational and training programmes should be developed in all areas of industry operation.

- 14.6 The Committee concludes that the essential nature of the protection insurance offers and the duty of care placed upon the agent and broker in advising his client on his protection needs necessitates a higher standard of qualifications to be set for agents and brokers than applied at present as a licencing condition.
- 14.7 The Committee also concludes that the same educational or examination qualification requirements be applied to both agents and brokers.
- 14.8 The Committee reaffirms its conclusion in the First Report that the activities of those sales persons employed by an insurance company are supervised adequately by the Superintendent's broad authority over the licenced insurance company. Accordingly it is the responsibility of the insurance companies to set internally a standard of qualification and competence for these persons commensurate with their duties and, at the least, equivalent to that imposed on outside sales intermediaries performing similar tasks.

The Committee regards sales persons as employees of an insurer if they are paid directly by salary or are on a commission basis but with the book of policyholder business designated as the property of the insurer. Qualification and licencing requirements need not, in the Committee's view, be applied to these individuals.

- 14.9 Persons who, for a fee, review, evaluate, recommend or advise regarding an insurance contract but do not place any insurance business with an insurance carrier should not, in the Committee's opinion, be included in licencing and associated qualification requirements. The consumer will be required to judge the competence of persons who hold themselves out as "insurance consultants" based on reputation and past performance. Alternatively, the consumer can choose to turn to a licenced broker who likewise acts as a consultant on a fee for service basis.
- 14.10 The Committee concludes that qualifying examinations and standards for agents and brokers be set by industry peer groups, subject to approval of the Superintendent. The Committee suggests that qualifying courses or examinations, as set by the peer group, be administered by the Insurance Institute of Ontario.

The Committee considers the association of Independent Insur-

ance Agents and Brokers of Ontario and the Toronto Insurance Conference to be sufficiently representative of their peers and more specifically of non-exclusive agents to be leading participants in developing qualification standards for all agents and brokers. Qualification under the standards set or administered by these various industry groups should not, however, require membership in these groups.

- 14.11 The Committee has considered a mandatory requirement for requalification of all agents and brokers but has concluded that this requirement is unnecessary at the present time, likely inefficient and of doubtful benefit. The Committee believes that the incentive to maintain competence should be otherwise established in the industry, for example through encouragement of voluntary participation in I.I.O. and I.I.A.B.O. continuing education courses. It would in fact be unfair to impose a requalification requirement on agents and brokers, when there are no such requirements imposed on the professions recognized in statute and when there is no evidence of widespread incompetence.
- 14.12 The licence of an agent or broker expires annually and must be renewed. The Committee views the annual renewal procedure as necessary and moreover directs the attention of the Superintendent to more careful monitoring of expired licences to make certain that unlicensed persons do not continue carrying on business as agents or brokers.
- 14.13 The Committee reaffirms its conclusion in the First Report that the insurance company on whose behalf an adjuster operates, even on a case-by-case basis, should be entirely responsible for the adjuster's conduct. The First Report further concluded that the Superintendent enjoys adequate authority over the actions of company adjusters and their qualifications, by his authority over licenced companies which are their employers.

In reaffirming these conclusions, the Committee questions the need for the licencing of "independent" or proprietor adjusters and encourages the Superintendent to examine this matter. Without the licencing requirement, insurance companies who employ proprietor adjusters would have to accept a much greater explicit responsibility for their activities and for their qualifications to adjust claims.

- 14.14 So long as the present licencing requirements continue, the Committee concludes that qualification standards should be maintained as an integral part of the conditions of practice of "independent" or proprietor adjusters. The qualifying standards should be set by an industry peer group, subject to the approval of the Superintendent. Administration of courses and possibly examination should be undertaken by

the Insurance Institute of Ontario, as an industry-wide educational organization.

- 14.15 The Committee repeats its recommendation in the First Report that persons without a licence or in the employ of unlicensed insurers should receive the permission of the Superintendent and pay a required fee before operating in this Province as special agents, brokers or adjusters.

Chapter 15—Standards of Conduct in the General Insurance Industry

- 15.1 The Committee reaffirms its conclusion in the First Report that Part XVIII of The Insurance Act, which includes a list of nine unfair and deceptive acts or practices, should be amended to permit the Lieutenant Governor in Council to make regulations defining such acts and practices as found to be appropriate to regulate conduct in the general insurance industry.

Amendment of Part XVIII will result in a more flexible regulation of conduct that is adaptable to changing market conditions, ways of doing business, and the adoption of new regulatory modes within the insurance industry or any of its sectors. At the same time it will limit the Superintendent's authority to those matters defined in regulation. It is the Committee's expectation that the making of regulations should be considered in the context of a minimum regulatory burden on the insurance industry.

- 15.2 The Committee proposes that tied selling be prescribed in regulation under Part XVIII as an unfair practice. The practice of requiring the purchase of one general insurance coverage as a condition of supplying another insurance product or any other product is generally prohibited under the federal Combines Investigation Act and, in the Committee's opinion, should as well be prohibited by regulation under The Insurance Act.
- 15.3 The Committee has reviewed with interest recent proposals for amendment of Part XIV regarding the general duties of sales intermediaries. Of specific interest in regard to conduct and the level of service to the consumer is the proposal for a statutory duty of care to be prescribed in The Insurance Act requiring the general lines agent to "advise those members of the public with whom he deals of the types and extent of insurance coverages available through him in the best interest of the insured or proposed insured". The Committee concludes that reference should be made in The Insurance Act to the general duties of an agent, broker and adjuster, both to the insurer and to the insured public; that these duties should be broadly defined; and that they should include the duty to advise the public of the types of available coverages. The Committee emphasizes, however, that in the case of agents

or brokers the provisions in the Act should not override the duty of care established in common law and the ability of the insured to recover damages as assessed by a court.

- 15.4 The Committee recommends that intermediate penalties, as well as the penalty of licence suspension, be provided for in the Act in the event that the duties defined in the Act are not met to the satisfaction of the Superintendent.
- 15.5 The Committee repeats its recommendation that the regulatory mode for supervising the conduct of insurance companies should be the monitoring of competition. Together with the review of other guidelines or regulations pertaining to solvency and group merchandising, and with the review and updating of Part XVIII of the Act dealing with unfair or deceptive acts and practices, the monitoring of competition as a mode of regulation will place a greater burden on the insurance industry to examine the conduct of its members and make improvements in the public interest.
- 15.6 Over the last two years, since its first investigations into automobile insurance, the Committee has been watching with interest the development of industry groups toward self-responsibility.

The Committee has recommended in this Report that the industry associations representing proprietor agents and adjusters should be given the responsibility of establishing qualification standards as part of the accreditation for licencing. The Committee encourages these same industry associations to demonstrate their ability to establish and *enforce* a code of conduct that will result in a high quality of service to the consumer and will justify the confidence placed by the consumer in the advice provided by the agent or broker. At the same time, the Committee cautions the insurance industry against building up accreditation or quality of service standards as excessive barriers to the entry of new industry participants or as contributors to an unnecessarily higher cost of service in the industry.

PART VIII:LOSS PREVENTION

Chapter 16—Consumer Protection: The Role of Loss Prevention

- 16.1 The Committee concludes that the major burden of responsibility in providing consumer protection through loss prevention falls on public measures. In many instances, community action and public safety regulations are the most effective means of controlling the incidence of loss. The Committee emphasizes the importance of and the need for efficient and effective loss prevention and protection services provided by the public sector.
- 16.2 At the same time, the Committee reminds the insurance industry of

its responsibility to contribute to public efforts at loss prevention. The Committee feels that the insurance industry should take on a greater cooperative role in loss prevention than it does at present.

- 16.3 In addition, the Committee encourages the insurance industry to develop and sell loss prevention services wherever it can identify a demand for "protection" rather than for claims settlement alone.
- 16.4 The Committee also urges the insurance industry to be more innovative and responsive in its ratemaking, so as to provide more premium incentives for loss reduction, particularly in residential lines.
- 16.5 In general, the Committee sees an array of efforts at all levels of government to cope with the fire threat to property and life. The delegation of major responsibility to the municipalities has resulted in disparities in firefighting service with a resulting differentiation in insurance rates. The Committee emphasizes the need for greater coordination in the provision and upgrading of fire abatement services in municipalities across the Province and urges the provincial government to devote more study to this matter.
- 16.6 The Committee recognizes arson as a disturbing, although not yet dominant factor, in increasing insurance costs. The Committee is most concerned by recent evidence of the growing seriousness of this crime, largely as linked with vandalism.

The Committee concludes that the seriousness of arson must be recognized in appropriate penalties commensurate with the extent of damages suffered by the community and that the necessary public resources be devoted to the investigation of arson fires and the apprehension of those persons who set these fires.

- 16.7 The investigation activities of the Insurance Crime Prevention Bureaux appear to be a worthwhile and effective industry initiative toward reducing the incidence of crime-related claims in the insurance system. It is apparent to the Committee that the mere fact of the existence of I.C.P.B. likely acts as a deterrent to certain types of insurance crime. The I.C.P.B. carry out an investigative role which is more detailed in time or expertise than can be undertaken by publicly funded fire and crime investigation services. In carrying out this role, the Committee emphasizes that the I.C.P.B. must continue to cooperate fully and coordinate its activities with the appropriate fire and police investigative authorities.
- 16.8 The inspection of residential properties does not appear to be a cost-effective measure for the insurance industry to undertake, although savings could be achieved in the insurance system through a general reduction in home hazards. Accordingly, it is the Committee's view that greater responsibility for risk inspection should fall on the mu-

municipal fire department, as part of increased emphasis on public fire prevention. The Committee makes the recommendation to municipal fire departments that door-to-door inspection campaigns be given a higher priority by the local fire departments, as educational efforts which alert residents to fire hazards and the need for their reduction.

- 16.9 The Committee encourages the insurance industry to explore ways of providing incentive for *individuals* to undertake loss prevention in regard to their personal property. Specific attention should be given to the applicability of providing industry-wide discounts for installation of loss prevention or protection systems which may include smoke detectors, anti-burglary devices, home fire extinguishers and other common precautionary devices.

As detailed in Chapter 11 of this Report, potential risk reduction factors would necessarily have to be included in statistical plans for collecting loss experience data in order to demonstrate their validity as rating factors.

- 16.10 The Committee encourages the insurance industry to generate and analyze more and better data on detailed causes of loss. These data are essential to a more accurate ratemaking process and may be useful sources of information to public bodies and to the business community. The Committee also encourages the insurance industry to participate in providing data to public statistical programmes regarding fire and non-fire losses. A greater coordination of data resources between the insurance industry and public bodies should be developed to assist in a better pooling of information on the causes of loss. The Committee concludes that the initiative in making public, information on the causes of loss should fall on the insurance industry.
- 16.11 The Committee has reviewed a special area of loss control activity, that being the inspection of boilers and pressure vessels under manufacture and in use in this Province. The Committee concludes, in regard to periodic inspections, that it would not be appropriate for the government to discontinue its service of periodic inspections of those boilers and pressure vessels which are not insured. If inspections, and consequently public safety standards, were to become the responsibility solely of the insurance industry, the Committee is concerned about the willingness of insurance companies to conduct routine inspections on the smaller boiler and pressure vessel installations in the more remote parts of the Province.
- 16.12 Likewise, the Committee regards continuing government inspection on manufacturers' premises as an essential aspect of public safety. The cost of such inspection should, however, be borne by the manufacturer and hence there is the need for development of fee schedules to reflect the full costs of inspection. The Committee sees no advan-

tage in shifting inspections to the insurance industry if fee schedules and personnel requirements in the Ministry are appropriately revised.

- 16.13 The Committee is nevertheless concerned about the backlog of inspections to be performed by the government inspection service and wonders whether there may also be a backlog of inspections by the insurance industry among insured boiler and machinery installations. There is an urgent need, likely at both levels, to make the inspection process more efficient and timely. The Committee lends its support to the Ministry's intention to study ways of improving the government inspection service.
- 16.14 In regard to compulsory liability insurance on boilers and pressure vessels, the Committee finds that liability for explosion or malfunction of a pressure vessel is normally covered under an organization's general liability policy. Accordingly, the Committee believes that greater emphasis should be placed on the availability and purchase of general liability coverage, at adequate limits of coverage and for a wide breadth of accident situations, including the explosion or malfunctioning of boilers and pressure vessels. The Committee does not see the need at the present time for compulsory insurance on boilers and pressure vessels.
- 16.15 In further areas of loss control, the Committee encourages the insurance industry in its continuing research into safety standards and loss prevention and in expansion into new areas of research, such as those related to crime and liability losses.
- 16.16 It is apparent to the Committee that the increasing complexity of materials, hazards and construction necessitates better, more sophisticated training of personnel in loss prevention and control. The insurance industry should assume more explicit responsibility in this area, be developing loss prevention expertise internally in the industry and by assisting businesses and public bodies in learning to work towards loss prevention. Continuing and wider support should be given by individual insurance companies to the activities of the Insurers' Advisory Organization and the Insurance Crime Prevention Bureaux in carrying out the training function.
- 16.17 Education of the public in loss prevention is a key area of loss control activity for both the insurance industry and government. After due consideration, the Committee has concluded that the education of the public regarding standards of care, maintenance and hazardous habits, such as smoking or drinking and driving, is a matter primarily of public responsibility.

The Committee nevertheless considers it to be in the insurance

industry's own self-interest, as well as the industry's responsibility as good corporate citizens, to undertake initiatives to educate the public in loss prevention. The insurance industry should find it in its own interest to "sell" education in loss prevention to its larger commercial accounts as an integral service, in the same way it now "sells" claims settlement. Application of this concept at the individual level should also be explored.

In regard to the education of the general public, the Committee also considers that the responsibilities of agents and brokers to advise their clients on coverage needs should encompass some measure of counselling on the topic of loss prevention, if only to remind clients of basic safety precautions.

- 16.18 In reviewing the various government and insurance industry activities in loss prevention, the Committee is led to question whether there is a need for coordination. The Committee suggests that a start in this direction be taken by a review carried out by the Superintendent and the Ontario Fire Marshal, in regard to the research, training, public education and, additionally, collection of data on fire losses, to determine the need for coordination of government and insurance industry activities in these areas of loss prevention and control.

PART IX: OTHER MATTERS

Chapter 17—Other Matters

- 17.1 The Committee recommends that greater emphasis be placed on arbitration of disputes in the insurance system. Accordingly, The Insurance Act should provide for a process of independent arbitration, according to conditions set out in The Arbitration Act. The process of arbitration should be made available to all insureds in the matter of disputes regarding all general insurance contracts, and not be restricted to the fire insurance contract.
- 17.2 The Committee recommends that the costs of arbitration be borne jointly by the insured and insurer, on a proportional basis to be decided by the arbitrator. The Committee expects that, in most instances, the costs of arbitration will be shared equally by both parties, unless there is an overriding reason which indicates that the demands of one party were unreasonable and hence that party should bear a greater share of the arbitration cost. The Committee also expects that each party will bear its own costs beyond those of the arbitration process.
- 17.3 To effect the recommendations regarding arbitration, the Committee recommends that Section 102 of The Insurance Act, referring to the procedure for appraisals, be broadened to provide for arbitration in

all contract-related matters, including but not restricted to appraisal. In the case of disputes requiring appraisals, the appointment of an "arbitrator" should be substituted for the current wording of appointment of an "umpire".

- 17.4 The Committee further recommends that the right to arbitration be brought to the consumer's attention by incorporating reference to arbitration in the statutory conditions which are part of every fire insurance contract and every automobile insurance contract in force in Ontario. In addition, reference to the arbitration process should be included in communication with the consumer, on the application form and on the explanatory brochure or pamphlet material attached to every policy, as proposed by the Committee earlier in this Report.
- 17.5 The Committee regards the payment of present and future damages on a periodic or instalment basis to be a more appropriate means of compensation for most cases of bodily injury than lump sum payments as made under the present system of compensation. Secondly, the Committee regards as desirable that insurers keep open their files on bodily injury claims to permit adjustments of payments as warranted by changes in the medical condition of the injured person. The intention of the Committee in these recommendations is to draw increased attention to the matter of rehabilitation.
- 17.6 The Committee in its Second Report stated that it was impressed with the opportunity presented by the no-fault system of compensation to establish a first-party settlement process that provides for direct accountability of the insurer to his own policyholder in the matter of claims. The Committee is further impressed with the direct compensation agreement undertaken by insurance companies in the Province of Quebec for settlement of third-party vehicle damage claims by the first-party insurer.

The Committee urges the insurance industry in Ontario to examine the application of the latter concept in the field of automobile insurance and in other liability areas. In bodily injury situations in particular, this approach would mean that an insurer providing personal liability coverage to an individual or homeowner would make payment to his insured and then endeavour to collect damages from the insurer of the negligent party. This measure is an intermediate step in the direction of no-fault compensation, as recommended by the Committee for implementation in the automobile insurance system.

- 17.7 The Committee considered in the Second Report the question of non-economic loss payments and their contribution to the cost of liability settlements. The Committee's proposal for a no-fault system of automobile compensation recognized the expectation by the public that

some compensation for non-economic losses such as pain and suffering should be made available but recommended that there be limits placed on the amount recoverable.

For “extraordinary” loss claims, the Committee considered \$100,000 to be a reasonable maximum for compensation, as suggested by recent decisions of the Supreme Court of Canada which apply to both automobile and other injury cases. The Committee supports the principle of a limit to pain and suffering awards in all liability situations and sees specific application of this principle in product liability situations.

17.8 In the Second Report, the Committee addressed recommendations on the matter of legal costs to the Law Society of Upper Canada regarding:

- vigilance against use of contingency fees;
- adequate and full disclosure by lawyers of their estimated fees to the client;
- the need for monitoring of legal costs.

The Committee repeats again its concerns regarding the use of contingency fees as an incentive toward frivolous claims and as a measure that is likely to add to the legal cost of liability settlements. These concerns would be particularly apparent should the right to class actions be extended in the future to new situations. In the Committee’s opinion, other means of facilitating access to legal advice and to the courts are available without the need for contingency fees.

17.9 The Committee recommends that the Superintendent and the Minister consider the public need for requiring, as a start, that all aircraft operating in Ontario carry public liability and passenger hazard insurance at least up to the limit mandatory for automobile liability, presently \$100,000. Liability coverage in such situations should not be breached by improper operation or condition of the aircraft.

Similarly consideration should be given to the need for mandatory liability coverage in regard to other modes of transportation not included in the automobile category.

17.10 The Committee recommends that all those persons licenced to practice as professionals in this Province and acting on behalf of the public be required to show proof of errors and omissions insurance or proof of membership in a self-insurance mechanism which is registered with the Office of the Superintendent for the provision of liability coverage.

17.11 The insurance industry should undertake to make available errors and

omissions coverage to professionals at the *true* cost of this coverage based on experience in this Province. Accordingly, the insurance industry should undertake to make improvements in its statistical data base and underwriting procedures to service the market for errors and omissions coverage more completely and effectively than at present or in the past.

- 17.12 The Committee encourages the insurance industry to participate in the public discussions of the Professional Organizations Committee regarding the availability of errors and omissions coverage for professionals and the problems associated with its provision.
- 17.13 The Committee sees the opportunity for the surety industry to become more responsive to the situation of contractors, as well as to that of owners, by:
- Defining clear criteria by which contractors will be judged in applying for a bond;
 - Developing within the surety industry a better understanding of local construction markets to ensure that the criteria for bonding are flexible in that they respond to local construction trade conditions;
 - Setting up a more permanent association between the surety and the small contractor. The contractor who does not often apply for a bond could maintain this association by payment of a retainer fee to the surety;
 - Developing “umbrella” bonds to reduce the proliferation and duplication of bonds issued to the various contractors working on the same construction job.
- 17.14 At the same time, the Committee sees the need *within the construction industry* to review the bonding process. Owners, architects, contractors and others must recognize the need to cooperate in developing alternatives to bonding or finding ways to ease bonding requirements. While it is unlikely and unrealistic for municipalities or other public bodies to dispense with the requirements of low bid contracting supported by a bond in tenders on publicly funded projects, other alternatives may be of benefit to both owners and contractors in the private construction industry.
- 17.15 The Committee also sees the opportunity for contractors to provide guarantees to owners through a self-bonding mechanism. Any review of the bonding process should include discussion of the acceptability to owners of a self-bonding system, wherein contractors group together to provide for guarantees on completion of contracts. The Superintendent is encouraged to take a participatory role in reviewing

any proposals for self-insurance as well as ensuring that no regulatory impediments are placed in the way of self-insurance.

- 17.16 The Committee requests the Superintendent to review The Marine Insurance Act to ensure that the principles of industry responsibility and government responsibility developed by the Committee in regard to The Insurance Act be applied where relevant to marine insurance contracts.

Specifically, the Superintendent should direct his attention to the necessity and advisability of subjecting marine insurance to the general application of The Insurance Act in this Province.

APPENDICES

APPENDIX A

(referred to in Preface)

LIST OF WITNESSES

A. MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

Honourable Larry Grossman, Q.C., M.P.P. Past Minister
Mr. Allan Pope, M.P.P., Parliamentary Assistant to the Minister of
Consumer and Commercial Relations

Office of the Superintendent of Insurance

Mr. Murray A. Thompson, Q.C., Superintendent of Insurance
Mr. Lear P. Wood, Director of Insurance Services
Mr. Martin T. Crutcher, Assistant Chief Examiner of Insurance
Companies
Mr. Michael Doherty, Registrar of Agents, Brokers and Adjusters
Mr. Ernest H. Miles, Director of The Motor Vehicle Accident Claims
Fund
Mr. Brian R. Newton, Senior Actuary
Mr. D. Sandilands, Assistant Co-ordinator, General Insurance

Technical Standards Division

Mr. Harry Y. Yoneyama, P.Eng., Executive Director
Mr. H. John Wright, Director, Pressure Vessels Branch

B. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. H. P. Hudson, Commissioner of Insurance, State of Indiana, President
of the N.A.I.C.;
Mr. Wesley J. Kinder, Insurance Commissioner, State of California,
Chairman of the Executive Committee;
Mr. Harold R. Wilde, Jr., Commissioner of Insurance, State of
Wisconsin, Chairman of the Competition Subcommittee;
Mr. Richard L. Mathias, Director of Insurance, State of Illinois, Chairman
of the Financial Condition, Examination and Reporting Committee;
Mr. Phillip O'Connor, Assistant to the Director of Insurance, State of
Illinois;
Mr. Robert E. Dineen, Consultant, N.A.I.C. Central Office;
Mr. Robert A. Bailey, Actuary-Director of the N.A.I.C. Data Base,
N.A.I.C. Central Office; and
Mr. Jon S. Hanson, Executive Secretary and Director of Research,
N.A.I.C. Central Office.

C. INDUSTRY ORGANIZATIONS

Insurance Bureau of Canada

- Mr. Alan A. Horsford, Chairman of I.B.C. and President of Royal Insurance Canada
Mr. Daniel Damov, Past President of I.B.C. and Executive Vice-President of Travelers of Canada
Mr. David E. Jackson, Secretary, Insurance Bureau of Canada
Mr. John R. A. MacKenzie, Member of the Board of Directors of I.B.C. and Chief Agent for Canada of the State Farm Insurance Companies
Mr. Edward H. S. Piper, Q.C., General Counsel
Mr. Carl Wilcken, General Manager

Insurance Bureau of Canada, Surety Committee

- Mr. E. T. Barr, Secretary of the Surety Committee
Mr. Gordon Cox, Travelers Insurance Company
Ms. Helen Gagne, Solicitor
Mr. Bruce C. Gordon, National Surety Chairman and Assistant Manager, United States Fidelity and Guarantee Company
Mr. J. A. Shand, National Surety Underwriting Manager, Canadian General Insurance Company

Insurer's Advisory Organization of Canada

- Mr. Edward F. Belton, President
Mr. Herbert J. Phillips, Vice-President and Chief Actuary
Mr. S. H. Ayres, Manager—Property Department
Mr. D. J. Horne, Assistant Director—Public Fire Protection Survey Services
Mr. James W. McCallister, Manager—Auto & Casualty Department
Mr. D. Michael McConnell, Assistant Actuary

Insurance Crime Prevention Bureaux

- Mr. Patrick J. Collins, General Manager
Mr. W. J. Fitzsimmons, Deputy Manager
Mr. Jean Claude Cloutier, Chief Superintendent
Mr. E. F. (Sam) Escubedo, Corporate Secretary

The Insurance Institute of Ontario

- Mr. William E. Toyne, Past President
Mr. J. C. Rhind, General Manager

Independent Insurance Agents and Brokers

- Mr. Basil N. Steggles, Vice-President and Chairman of the Legislative Committee

Mr. Herb F. Baker, General Manager
Mr. Fred G. Funston, General Manager, Canadian Federation of Insurance
Agents and Brokers Associations

Toronto Insurance Conference

Mr. Bryce Hunter, President and Vice-President, Hunter Rowell & Co.
Limited
Mr. Jack Cross, Vice-President and Senior Vice-President, Reed Shaw
Stenhouse Limited
Mr. Norman Amondson, Chairman Casualty Committee and
Vice-President, Marsh and McLennan Ltd.
Mr. Jim Cramb, Chairman Property Committee and Vice-President and
Director, Tomenson Saunders Whitehead Limited

Ontario Insurance Adjusters Association

Mr. James J. Allan, President

Ontario Mutual Insurance Association

Mr. Vernon T. Inglis, President of O.M.I.A. and Secretary-Manager of
the Formosa Mutual Fire Insurance Company
Mr. Mel McIntyre, Executive Secretary of O.M.I.A.
Mr. Max Forsythe, Past President of O.M.I.A., and President of the Farm
Mutual Reinsurance Plan Inc.
Mr. Bruce Bird, Manager-Treasurer of the Farm Mutual Reinsurance Plan
Inc.
Mr. A. Bruce Caughey, Past President of O.M.I.A. and President Amherst
Island Mutual Fire Insurance Company
Mr. Gordon L. Welsh, Past President of O.M.I.A., and
Secretary-Manager of Dumphries Mutual Fire Insurance Company

Canadian Boiler & Machinery Underwriters Association

Mr. Shaun P. Bryan, Boiler and Machinery Manager, Royal Insurance
Mr. C. A. (Skip) Williams, Vice-President, The Boiler Inspection and
Insurance Co. of Canada

**D. INDIVIDUAL INSURANCE COMPANIES, AGENTS,
BROKERS, ADJUSTERS**

The Allstate Insurance Companies of Canada

Mr. Gerald J. Fournier, President and Chief Operating Officer
Mr. John Drennan, Senior Actuary, Allstate Insurance Company in the
United States

The Canadian Indemnity Company

Mr. Harley Vannan, President
Mr. Gordon Mussell, Casualty Manager

Canadian Industrial Risks Insurers

Mr. S. J. Davidson, Chairman, Government Committee of C.I.R.I. and
Vice-President, The Dominion of Canada General Insurance
Company
Mr. Ronald Berler, Underwriting Manager, C.I.R.I.

Canadian Reinsurance Company

Mr. Robert F. Clark, Deputy Chairman

Factory Mutual System

Mr. Tiit Pikksalu, Eng., Vice-President, Manager Canadian Operations,
Allendale Mutual Insurance Company
Mr. David L. Johnson, Vice-President, General Counsel and Assistant
Secretary, Allendale Mutual Insurance Company

Harriott & Associates of Canada (1974) Limited

Mr. Claire W. Miller, President

Jamieson-Hilts Insurance Agency Limited, Woodstock

Mr. Jim Jamieson, F.I.I.C.

Munich Reinsurance Company of Canada

Mr. John M. Coker, President

Royal Insurance Canada

Mr. Alan A. Horsford, President and Chief Executive Officer
Mr. J. Robitaille, Executive Vice-President
Mr. Roy A. Elms, Executive Vice-President
Mr. William Campbell, Senior Vice-President
Mr. K. C. Walduck, Senior Vice-President
Mr. Leon K. Albrecht, Vice-President
Mr. R. W. Radford, Vice-President
Mr. Peter M. Shepherd, Vice-President, Branch Operations
Mr. Alan R. Westbrook, Vice-President and Investment Manager
Mr. Donald J. Courtney, Administration Manager
Mrs. Nancy G. Godwin, Investment Manager
Mr. Grant H. Ince, Branch Marketing Manager

Mr. Kip Van Kempen, Training Supervisor
Mr. Karl Von Levetzow, Underwriting Manager
Mr. Jim Mason, Branch Underwriting and Marketing Manager
Mr. A. Rennie, Boiler and Machinery Manager
Mr. Barry J. Robinson, Personal Lines Manager
Mr. E. R. Snow, Property Manager—Loss & Claims Service
Mr. J. Dann Thompson, Branch Manager

State Farm Fire & Casualty

Mr. Andrew Spohr, Underwriting Superintendent

E. OTHERS

Appraisal Institute of Canada

Mr. Gerald A. Rouleau, President
Mr. J. D. H. Mackenzie, Past President

Arbitrators' Institute of Canada

Mr. Donald Martin, Representative
Mr. Ralph B. Payne, Past Chairman, Reed, Shaw Osler Limited
Mr. Paul B. Walters, Paul B. Walters & Associates Ltd.

Peter Armour Insurance Counselling Limited

Mr. Peter J. Armour

Mr. R. M. Burnard, P.Eng.

Canadian Household Goods Carriers' Tariff Bureau Association

Mr. W. David McConnell, Executive Vice-President and Manager

Canadian Manufacturers' Association

Mr. G. C. Hughes, Director of Legislation Taxation and Technical Group
Mr. Douglas Montgomery, Manager Legislation Department
Mr. Grant Murray, Q.C., Secretary, Vice-President and General Counsel,
I.B.M. Canada Limited

Canadian Medical Protective Association

Dr. F. Norman Brown, Secretary/Treasurer
Mr. Charles F. Scott, Q.C., General Counsel

City of Toronto, Council

Mr. Richard Gilbert, Aderman Ward 3

Mr. Colin Hughes, Director of Research and Information, Development
Department

City of Toronto, Fire Department

Mr. William Sproule, Chief Fire Prevention Officer, Fire Prevention
Bureau

Connaught Laboratories Limited

Mr. A. K. Aagaard, Director, Finance and Secretary-Treasurer

The Consumers' Association of Canada (Ontario)

Mrs. Barbara J. Shand

Mr. Edward Deibel, Alderman, City of North Bay

General Appraisal of Canada Limited

Mr. Ronald G. Dawkins, Regional Manager

R. W. Hope Limited, Construction & Appraisals

Mr. Robert Hope, President

*Mr. William McLeod, Professor of Business Administration, Cambrian
College, Sudbury.*

Mechanical Contractors Association Ontario

Mr. W. T. A. Nicholls, Executive Vice-President

Mr. Derwert Lewis, Executive Vice-President, Toronto Chapter

Mr. Larry Monette, Contractor

The Metropolitan Trust Company of Canada

Mr. Stewart Ripley, President

Ministry of The Solicitor General Office of The Ontario Fire Marshal

Mr. John R. Bateman, Fire Marshal

Mr. Alan C. Williams, Deputy Fire Marshal, Chief Investigative Officer

Ontario Association of Architects

Mr. Vladan Milic, President O.A.A. and Partner, Adamson Associates
Architects Planners

Mr. Brian Parks, Executive Director O.A.A.

Mr. Lyle Brown, Counsel to O.A.A. in matters dealing with contractors

Ontario Crop Insurance Commission

Mr. Henry Ediger, General Manager

Ontario General Contractors Association

Mr. E. R. Fenton, Executive Director

Mr. Crawford, Contractor

Ontario Hospital Association

Mr. Roger Slute, Assistant Executive Director, Association Services

Ontario Law Reform Commission

Mr. Stephen Waddams, Project Director, Study on Products Liability, and
Professor, Faculty of Law, University of Toronto

Ontario Risk & Insurance Management Society

Ms. Pamela Dixon, President

Mr. Robert S. Best, Director, Legislation

Mr. Donald M. Stuart, Past Chairman, Legislation Committee

Ontario Trucking Association

Mr. Venning, Director of Operations, Safety and Security

Mr. J. Cargill, Director of Purchasing and Insurance, Smith Transport

Mr. George Campbell, Director of Claims, Smith Transport

The Public Insurance Administrators' Association of Ontario

Mr. George R. Peterson, Insurance Administrator, Borough of
Scarborough

Mr. Max L. Rapoport, Q.C.

Tellus Instruments Limited

Mr. Frank W. Emerson, President

Mr. Barry Butcher, Marketing Manager

Mr. Richard MacDuffee, R. MacDuffee and Associates Limited

Underwriters' Adjustment Bureau Limited

Mr. Ridley Williams, Executive General Adjuster

Underwriters' Laboratories of Canada

Mr. David S. Martin, General Manager

Mr. N. S. Pearce

APPENDIX B
(referred to in Preface)

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APPENDIX C
(referred to in Chapter 3)

**LIST OF ORGANIZATIONS OPERATING IN THE
PROPERTY AND CASUALTY INSURANCE BUSINESS IN
ONTARIO AS AT DECEMBER 31, 1977**

The sources of the information used in this Appendix are as follows:

1. Company Name

- Section V of the 1977 Annual Report of the Superintendent of Insurance of Ontario lists all the organizations writing property and casualty insurance in Ontario and the premiums they write.

2. Enabling Legislation

- The Annual Report of the Superintendent of Insurance of Ontario for Ontario companies and the Annual Report of the Federal Superintendent of Insurance for the Canadian, British and Foreign companies list the origin of the enabling legislation which defines the jurisdiction over reporting requirements.

3. Affiliation by Group

- The annual statistical issue of *Canadian Insurance* provides this information. (While other affiliations may exist, only those shown by *Canadian Insurance* have been used.)

4. Year Licenced

- The individual financial statements of organizations contained in both the Provincial and Federal Superintendents' Annual Reports indicate the year licenced.

5. Ownership

- Ownership is defined on the basis of an analysis by the Ontario Department of Insurance.

6. Direct Premiums Written

- Section V of the 1977 Annual Report of the Superintendent of Insurance of Ontario lists all organizations writing property and casualty insurance in Ontario and the premiums they write.

LIST OF ORGANIZATIONS OPERATING
IN THE PROPERTY AND CASUALTY INSURANCE BUSINESS
IN ONTARIO, AS AT DECEMBER 31, 1977

Company	Enabling Legislation	Affiliation by Group	Year Licenced	Ownership	Direct Premiums Written in Ontario - 1977 by Ownership	
					Canadian	Foreign
Abstainers Insurance Company	Canadian		1956	Canadian	\$ 1,070,285	
Aetna Casualty Company of Canada	Foreign		1972	Foreign		\$ 9,571,911
Aetna Casualty and Surety Company	Foreign		1927	Foreign		3,960,987
Aetna Insurance Company	Foreign		1868	Foreign		552,358
Affiliated FM Insurance Company	Foreign		1955	Foreign		3,782,647
Albion Insurance Company of Canada	Canadian	Dale and Company Group	1957	Foreign		346,413
Allendale Mutual Insurance Company	Foreign	Factory Mutual System	1936	Foreign		18,378,254
Allstate Insurance Company	Foreign		1949	Foreign		2,109
American Bankers Insurance Company of Florida	Canadian		1962	Foreign		14,705,053
American Credit Indemnity Company	Foreign		1968	Foreign		1,079,402
American Home Assurance Company	Foreign		1923	Foreign		519,299
American Insurance Company	Foreign		1966	Foreign		13,401,784
American Mutual Liability Insurance Company	Foreign	Shaw & Begg Group	1912	Foreign		1,436,366
American National Fire Insurance Company	Foreign		1947	Foreign		140,534
American Reinsurance Company	Foreign	Great American Insurance Co.'s	1953	Foreign		11,625
American Road Insurance Company	Foreign		1968	Foreign		202,116
Anglo Canada General Insurance Company	Foreign		1963	Foreign		31,135
Argonaut Insurance Company	Ontario	Anglo-Gibraltar Group	1949	Foreign		2,938,790
Arkwright-Boston Manufacturers - Mutual Insurance Company	Foreign		1971	Foreign		841
Aviation and General Insurance Company	Foreign	Factory Mutual System	1927	Foreign		6,041,842
Balboa Insurance Company	British		1946	Foreign		132,262
The Baloise Insurance Company Limited	Foreign		1969	Foreign		97,720
Baltica - Scandinavia	Foreign	New Zealand Group	1953	Foreign		44,193
Bay City General Insurance Company	Canadian		1977	Foreign		21,496
Boiler Inspection and Insurance Company of Canada	Ontario	Simcoe Bay Group	1963	Canadian	273,737	
British Aviation Insurance Company Limited	Canadian		1875	Foreign		4,021,127
British Economic Insurance Company Limited	British		1943	Foreign		1,216,343
Buffalo Insurance Company	Foreign		1971	Foreign		3,454
Calvert Fire Insurance Company	Foreign		1940	Foreign		515,056
The Canada Accident and Fire Assurance Company	Canadian	Commercial Union Assurance Group	1948	Foreign		976,890
Canadian Security Assurance Company	Canadian	Norwich Union Insurance Group	1888	Foreign		1,998,947
Canadian General Insurance Company	Canadian	Canadian General Group	1920	Foreign		(619)
Canadian Home Assurance Company	Canadian	Canadian Home Group	1908	Foreign		
The Canadian Indemnity Company	Canadian		1950	Canadian	14,643,496	
The Canadian Mercantile Insurance Company	Canadian	Commerce Group	1919	Canadian	14,931,136	
			1937	Canadian	5,455	

The Canadian Millers Mutual Fire Insurance Company	Ontario	Independent Insurance Managers Group	1878	737,449	Canadian
The Canadian Provincial Insurance Company	Canadian	Canadian Surety Group	1957		Foreign
The Canadian Surety Company	Canadian		1913		Foreign
Canadian Universal Insurance Company Ltd.	Canadian		1944		Foreign
Cannex Exchange Subscribers at Warner Inter-Insurance Bureau	Foreign		1925		Foreign
The Casualty Company of Canada	Foreign	Dominion of Canada Group	1915	4,363,530	Canadian
Centennial Insurance Company	Foreign	Fire of Canada Centennial Group	1952		Foreign
Central Mutual Insurance Company	Foreign		1923		Foreign
The Century Insurance Company of Canada	Canadian		1908		Foreign
Chateau Insurance Company	Canadian		1975	9,834,329	Canadian
Chicago Title Insurance Company	Foreign		1967		Foreign
Chrysler Life Insurance Company of Canada	Foreign		1967		Foreign
CNA Assurance Company	Canadian	CNA Assurance Companies	1946		Foreign
Commerce and Industry Insurance Company	Ontario	Commerce Group	1966		Foreign
The Commerce General Insurance Company	Canadian	Commercial Union Assurance Group	1928	2,336	Canadian
Commercial Union Assurance Company of Canada	Canadian		1975		Foreign
Commonwealth Insurance Company	British		1863		Foreign
Consolidated Fire and Casualty Insurance Company	Canadian		1951	5,273,124	Canadian
Constitution Insurance Company of Canada	Canadian	Shaw & Begg Group	1931		Foreign
The Continental Insurance Company	Canadian		1962		Foreign
The Contingency Insurance Company Limited	Foreign	Continental Insurance Companies	1910		Foreign
Co-Operative Fire and Casualty Company	British		1974		Foreign
Co-Operators Insurance Association	Canadian		1952	\$ 520,612	Canadian
Cornhill Insurance Company Limited	Ontario		1951	19,561,434	Canadian
Coronation Insurance Company Limited	British	Independent Insurance Managers Group	1922		Foreign
Cumis Insurance Society Inc.	Ontario		1954	\$ 1,232,613	Foreign
The Dominion Insurance Corporation	Foreign		1966	2,101,150	Foreign
The Dominion of Canada General Insurance Company	Canadian	Continental Insurance Companies	1907	1,687,652	Foreign
The Drake Insurance Company Limited	Canadian	Dominion of Canada Group	1887	9,269,410	Foreign
Eagle Star Insurance Company Limited	British		1975	17,875,887	Canadian
Eaton/Bay Insurance Company	Foreign	Eagle Star Group	1975		Foreign
Ecclesiastical Insurance Office Limited	Foreign		1912		Foreign
The Economical Mutual Insurance Company	Canadian		1907		Canadian
Elite Insurance Company	British		1972	1,863,024	Foreign
Elite Insurance Company	Canadian		1936		Canadian
Emeco Insurance Company	Canadian		1954	27,034,770	Canadian
Employers Mutual Liability Insurance - Company of Wisconsin	Foreign		1954	2,166,236	Foreign
Employers Reinsurance Corporation	Foreign	Employers Insurance of WAUSAU	1951	546,349	Foreign
English and American Insurance Company Limited	Foreign	Employers Insurance of WAUSAU	1927	1,029,529	Foreign
Federal Fire Insurance Company of Canada	British		1947	1,016,579	Foreign
Federal Insurance Company	Canadian	Shaw & Begg Group	1937	551,743	Foreign
Federated Mutual Insurance Company	Foreign	Chubb & Son Group	1929	1,328,270	Foreign
Fidelity Insurance Company of Canada	Foreign		1920	15,009,621	Foreign
Fidelity Insurance Company of Canada	Canadian	Federation Insurance Group	1920	3,761,754	Foreign
The Fire Insurance Company of Canada	Canadian	U.S. Fidelity Group	1948	2,992,135	Foreign
Fireman's Fund Insurance Company	Canadian	Fire of Canada - Centennial Group	1922	3,192,640	Foreign
Fireman's Fund Insurance Company of Canada	Foreign	Shaw & Begg Group	1918		Foreign
First National Insurance Company of America	Foreign	Shaw & Begg Group	1930	7,279,595	Foreign
Florist's Mutual Insurance Company	Foreign	Safeco Insurance Companies	1977	12,016,015	Foreign
			1961		Foreign
			1955	713,079	Foreign

Company	Enabling Legislation	Affiliation by Group	Year Licenced	Direct Premiums Written in Ontario - 1977 by Ownership	
				Canadian	Foreign
Foremost Insurance Company - Grand Rapids	Foreign		1969		3,377
Foresters Indemnity Company	Canadian		1974		961,911
The General Accident Assurance Company of Canada	Canadian		1969		28,530,070
General Insurance Company of America	Foreign		1926		573,681
General Security Insurance Company of Canada	Canadian	Safeco Insurance Companies	1942	1,872,485	
Gerling Global General Insurance Company	Ontario	Gerling Global Group	1956		10,213,011
Gibraltar General Insurance Company	Ontario	Anglo-Gibraltar Group	1958		9,988,703
The Globe Indemnity Company of Canada	Canadian	Royal Insurance Group			1,754,647
Gore Mutual Insurance Company	Canadian		1937	11,947,752	
Grain Insurance and Guarantee Company	Canadian		1972	400,412	
Great American Insurance Company	Foreign	Great American Insurance Co's.	1904		5,385,995
Great Eastern Insurance Company	Canadian	Monitor Underwriting Management Ltd.	1953		7,563,670
The Guarantee Company of North America	Canadian		1872		7,649,904
Guardian Insurance Company of Canada	Canadian		1911		19,538,195
The Halifax Insurance Company	Canadian		1919		8,759,460
The Hanover Insurance Company	Foreign	Dale and Company Group	1929		1,454,460
The Hartford Fire Insurance Company	Foreign	Hartford Group	1836		3,540,785
Herald Insurance Company	Foreign	Crum & Forster of Canada	1973		9,144,877
Highlands Insurance Company	Canadian		1975		4,977
The Home Insurance Company	Foreign		1902		3,981,659
The Hudson Bay Insurance Company	Canadian	Royal Insurance Group	1910		468,765
Ideal Mutual Insurance Company	Foreign		1970		158,943
Imperial Guarantee & Accident Insurance Company of Canada	Canadian	Royal Insurance Group		1,753,923	49,980
Insmore Mortgage Insurance Company	Canadian		1928		
Insurance Company of North America	Foreign		1889		13,761,423
The Insurance Corporation of Ireland Limited	Foreign		1951		9,136,731
Lawyers Title Insurance Corporation	Foreign		1957		57,130
Liberty Mutual Fire Insurance Company	Foreign	Liberty Mutual Group	1925		2,471,230
Liberty Mutual Insurance Company	Foreign	Liberty Mutual Group	1936		2,763,198
Lloyd's	British		1935		24,080,622
The London Assurance	British	Sun Alliance & London Group	1869		294,626
London Canada Insurance Company	Canadian	Hartford Group	1836		131,065
London & Midland General Insurance Company	Canadian		1948		1,535,879
Lumbermens Mutual Casualty Company	Foreign		1920	\$ 6,570,883	
Lumbermens Underwriting Alliance	Foreign		1918		1,484,120
Maritime Insurance Company Limited	British		1949		923,254
Market Insurance Company of Canada	Canadian		1972		2,057,760
Maryland Casualty Co.	Foreign		1903		244
Middlesex Insurance Company	Foreign		1968		(26,302)
Midland Insurance Company	Foreign		1970		74,101

The Missisquoi and Rouvelle Insurance Company	Canadian	1951	Economical Group	Canadian	\$ 1,488	
The Mortgage Insurance Company of Canada	Canadian	1964		Canadian	8,883,008	
Motors Insurance Corporation	Foreign	1956		Foreign		2,939,477
National Employer's Mutual General Insurance	British	1949		Foreign		42,696
New Hampshire Insurance Company	Foreign	1918		Foreign		1,977,754
New India Assurance Company Limited	British	1953	Dale & Company Group	Foreign		660,546
The New Zealand Insurance Company Limited	British	1943	New Zealand Group	Foreign		316,112
Niagara Fire Insurance Company	Foreign	1912		Foreign		1,852
North American Company for Property and Casualty Insurance	Foreign					
North American Life and Casualty Company	Foreign	1945		Foreign		271,795
Northumberland General Insurance Company	Foreign	1948		Foreign		208,143
The North Waterloo Farmers' Mutual Insurance	Canadian	1960		Canadian	10,832,741	
Norwich Union Fire Insurance Society Limited	Canadian	1958		Canadian	5,977,730	
Old Republic Insurance Company	British	1880	Norwich Union Insurance Group	Foreign		230,444
Olympic Insurance Company	Foreign	1956		Foreign		20,050
Ontario Mutual General Insurance Company	Foreign	1959	Canadian Surety Group	Foreign		12,594
The Orion Insurance Company Limited	Ontario	1904		Canadian	2,111,783	
Otter-Dorchester Mutual Insurance Company	British	1949	Dale & Company Group	Foreign		2,766,752
Pacific Employees Insurance Company	Ontario	1888		Canadian	3,065,439	
La Paix General Insurance Company of Canada	Foreign	1969		Foreign		13,258
Pearl Assurance Company Limited	Canadian	1956	Le Group la Laurentienne	Foreign		317,166
The Personal Insurance Company of Canada	British	1927		Foreign		8,449
Perth Insurance Company	Canadian	1974		Foreign	702,724	
Philadelphia Manufacturers' Mutual Insurance Company	Canadian	1953	Economical Group	Canadian	2,869,464	
Phoenix Assurance Company of Canada	Foreign	1928	Factory Mutual System	Foreign		1,713,471
Phoenix Assurance Company of Canada	Canadian	1905	Phoenix of Canada Group	Foreign		12,077,130
Pilot Insurance Company	British	1804	Phoenix of Canada Group	Foreign		847,884
Pitts Insurance Company	Ontario	1927		Foreign		11,087,538
The Portage la Prairie Mutual Insurance Company	Canadian	1971		Canadian	1,002,211	
Protection Mutual Insurance Company	Canadian	1930		Canadian	828,586	
Providence Washington Insurance Company	Foreign	1927	Factory Mutual System	Foreign		7,397,649
The Provident Assurance Company	Foreign	1912		Foreign		973,977
The Prudential Assurance Company Limited of England	Ontario	1952		Canadian	10,819	
QBE Insurance Company	British	1923		Foreign		9,178,152
Quebec Assurance Company	Foreign	1965		Foreign		(1,822)
Reliance Insurance Company	Canadian	1869	Royal Insurance Group	Foreign		67,694
Retail Lumberman's Inter-Insurance Exchange	Foreign	1918		Foreign		7,729,011
The Retail Lumbermen's Mutual Fire Insurance	Foreign	1917		Foreign		30,901
Royal Exchange Assurance of America Incorporated	Ontario	1949		Foreign		2,471
Royal General Insurance Company of Canada	British	1974		Foreign		286,579
Royal Insurance Company of Canada	Canadian	1964	Continental Insurance Companies	Foreign		32,605
St. Paul Fire and Marine Insurance Company	Canadian	1835	Royal Insurance Group	Foreign		64,806,063
Safeco Insurance Company of America	Foreign	1907	St. Paul Insurance Companies	Foreign		7,290,487
Scottish & York Insurance Company Limited	Foreign	1958	Safeco Insurance Companies	Foreign		2,866,005
The Scottish Union and National Insurance Company	Ontario	1961		Foreign		4,728,138
Seaboard Surety Company	British	1882	Norwich Union Insurance Group	Foreign		(6,028)
Security Insurance Company of Hartford	Foreign	1962		Foreign		468,782
	Foreign	1921		Foreign		821,168

APPENDIX C

Company	Enabling Legislation	Affiliation by Group	Year Licenced	Ownership	Direct Premiums Written in Ontario - 1977 by Ownership	
					Canadian	Foreign
Security Mutual Insurance Company	Foreign		1955	Foreign	1,386,307	626,870
Security National Insurance Company	Canadian		1935	Canadian		
Sentry Insurance a Mutual Company	Foreign		1945	Foreign		1,062,632
Simcoe & Erie General Insurance Company	Ontario	Simcoe Bay Group	1959	Canadian	16,154,494	
The Sovereign General Insurance Company	Canadian		1953	Canadian	3,723,237	
The Sovereign Mortgage Insurance Company	Canadian		1973	Canadian	2,306,979	
The Stanstead & Sherbrooke Insurance Company	Canadian	Commercial Union Assurance Group	1940	Foreign		710,375
State Farm Fire and Casualty Company	Foreign	State Farm Insurance Co's.	1954	Foreign		\$ 12,244,290
Sun Alliance Insurance Company	Canadian	Sun Alliance & London Group	1956	Foreign		9,556,992
Switzerland General Insurance Company Limited	Foreign	Federation Insurance Group	1935	Foreign		306,399
The Tokio Marine and Fire Insurance Company	Foreign		1960	Foreign		257,489
Toronto General Insurance Company	Canadian	Canadian General Group	1937	Canadian	\$ (59)	
Traders General Insurance Company	Canadian	Canadian General Group	1951	Canadian	1,987,325	
Transamerica Insurance Company	Foreign	Canadian Surety	1963	Foreign		287
Transport Indemnity Company	Foreign		1957	Foreign		167,625
Transport Insurance Company	Foreign		1964	Foreign		199,611
Transportation Fire and Casualty Company	Ontario	CNA Assurance Companies	1949	Canadian	826,064	
The Travelers Indemnity Company	Foreign	Travelers Insurance Companies	1912	Foreign		2,394,664
Travelers Indemnity Company of Canada	Canadian	Travelers Insurance Companies	1921	Foreign		6,153,078
United Canada Insurance Company	Canadian		1960	Foreign		585,970
The United Provinces Insurance Company	Ontario	The United Provinces Group	1955	Canadian	43,876	
United States Fidelity and Guarantee Company	Foreign	U.S. Fidelity Group	1903	Foreign		11,154,047
United States Fire Insurance Company	Foreign	Crum & Forster of Canada	1919	Foreign		8,471,519
The Unity Fire and General Insurance Company	Foreign	Independent Insurance Managers Group	1946	Foreign		187,301
Upper Canada Insurance Company	Ontario		1948	Canadian	519,899	
Utica Mutual Insurance Company	Foreign		1968	Foreign		499,549
Victoria Insurance Company of Canada	Canadian		1956	Canadian	1,868,861	
Warner Reciprocal Insurers	Foreign		1926	Foreign		5,229
The Waterloo Mutual Insurance Company	Canadian		1960	Canadian	8,665,371	
The Wawanesa Mutual Life Insurance Company	Canadian		1930	Canadian	8,775,486	
The Western Assurance Company	Canadian	Royal Insurance	1868	Foreign		27,092,973
Western General Mutual Insurance Company	Canadian		1968	Canadian	9,231,853	
Western Surety Company	Canadian		1961	Canadian	430,257	
The Yasuda Fire and Marine Insurance Company	Foreign		1975	Foreign		404,737
York Fire & Casualty Company	Ontario		1955	Canadian	507,575	
Zurich Insurance Company	Foreign		1923	Foreign		24,553,425
					<u>\$229,059,513</u>	<u>\$647,788,565</u>

Reinsurers

Abaille-Paix Reassurances Bee Fire, Hail, Accident and General Insurance Company	Foreign			1977	Foreign
Business Men's Assurance Company of America	Foreign			1967	Foreign
Canadian Reinsurance Company	Foreign			1956	Foreign
Farm Mutual Reinsurance Plan Inc.	Canadian		Canadian Reinsurance Group	1953	Foreign
General Reassurance Corporation	Ontario			1969	Canadian
Gerling Global Reinsurance Company	Foreign			1929	Foreign
Great Lakes Reinsurance Company	Ontario		Gerling Global Group	1957	Foreign
Hartford Steam Boiler Inspection and Insurance Company	Canadian			1952	Foreign
Kanata Reinsurance Company	Foreign		Hartford Group	1936	Foreign
Mercantile and General Reinsurance Company of Canada	Canadian			1977	Foreign
Mercantile and General Reinsurance Company Limited	Canadian		Mercantile and General Reinsurance Group	1951	Foreign
Munich Reinsurance Company	British				
Munich Reinsurance Company of Canada	Foreign		Mercantile and General Reinsurance Group	1951	Foreign
National Reinsurance Company of Canada	Canadian		Munich Reinsurance Group	1957	Foreign
Nationwide Mutual Insurance Company	Canadian		Munich Reinsurance Group	1960	Foreign
Netherlands Reinsurance Group N.V.	Foreign			1976	Canadian
Nordisk Reinsurance Company Limited	Foreign		Universal Reinsurance Group	1959	Foreign
North American Reinsurance Corporation	Foreign		Universal Reinsurance Group	1971	Foreign
North American Reassurance Company	Foreign		Universal Reinsurance Group	1947	Foreign
Norwich Winterthur Reinsurance Corporation Ltd.	Foreign		Canadian Reinsurance Group	1945	Foreign
Prudential Insurance Company of America	British			1958	Foreign
Reinsurance Corporation of New York	Foreign			1953	Foreign
Skandia Insurance Company	Foreign			1925	Foreign
Societe Commerciale de Reassurance	Foreign			1971	Foreign
Scorebrand International Reinsurance Company Ltd.	Foreign			1949	Foreign
Swiss Reinsurance Company	Foreign		Universal Reinsurance Group	1975	Foreign
Union Reinsurance Company	Foreign		Universal Reinsurance Group	1948	Foreign
Victory Insurance Company Limited	British		Universal Reinsurance Group	1959	Foreign
			Universal Reinsurance Group	1949	Foreign
			Universal Reinsurance Group	1941	Foreign

APPENDIX D

(referred to in Chapter 3)

ASSUMPTIONS AND BASIS OF PRESENTATION OF DATA ON THE PROFITABILITY AND OPERATING COST STRUCTURE OF THE GENERAL INSURANCE INDUSTRY IN ONTARIO

A. INTRODUCTION

This Appendix outlines the sources of information, the assumptions and the data used in the analysis of the profitability and operating cost structure of the general insurance industry in Ontario, as presented in Chapter Three of this Report.

The financial data in this Appendix are assembled from a combination of four sources: (1) Annual Reports of the Superintendent of Insurance for Canada, (2) Annual Reports of the Superintendent of Insurance for the Province of Ontario, (3) S-9 Reports on Operating Results by Product Line for all Canada filed annually with the Provincial Superintendent, and (4) operating statistics from the Insurance Bureau of Canada Expense Allocation and Reporting System. Certain of the data in this Appendix, relating to the 1977 operations of the general insurance industry in Ontario, have been obtained from unedited drafts of the 1977 Annual Report of the Superintendent of Insurance for the Province of Ontario.

All organizations writing insurance in Canada must report the financial results of their operations directly to at least one of the Provincial Departments of Insurance or to the Federal Department of Insurance. The Ontario and Federal reporting requirements are the same as for the automobile insurance industry and were set out in some detail in the First Report.¹

The general insurance industry, in stressing a solvency or liquidation approach to the valuation of assets and liabilities, has traditionally not followed accounting principles which are generally accepted in other commercial enterprises. A comparison of the accounting principles used in the general insurance in the industry with those found in other commercial enterprises was provided in the First Report.² It is worthy to note that recent changes in The Canadian and British Insurance Companies Act now permit, but do not yet require, federally registered general insurance companies to follow generally accepted accounting principles. It is anticipated that reporting on this more informational and useful basis may be compulsory for the 1979 accounting year.

In addition to the reporting requirements of the Provincial and Federal Superintendents, members of the Insurance Bureau of Canada report operating data under the I.B.C. Expense Allocation and Reporting System. A re-

1. *First Report on Automobile Insurance*, pages 193 to 195.

2. *First Report on Automobile Insurance*, Appendix M.

view of I.B.C. membership in 1977 indicates that members wrote approximately 80% of the property insurance business in Ontario and 85% of liability insurance premiums. Certain of the analyses in this Appendix rely on the operating statistics produced by the I.B.C. Expense Allocation and Reporting System and, in such cases, it is assumed that these statistics are representative of the Ontario industry as a whole.

The assumptions and presentation of data on the profitability and operating cost structure of the general insurance industry in Ontario are outlined in this Appendix under the following headings:

B. Notes on Preparation of Estimated Income Statements

C. Estimated Income Statement Tables

Table 1—Property Insurance

Table 2—Liability Insurance

Table 3—Other Lines Insurance

Table 4—Personal and Commercial Property Insurance

Table 5—Automobile Insurance

D. Notes on Return on Equity Calculations

E. Notes on Preparation of Estimated Operating Cost Profile

F. Estimated Operating Cost Profile Tables

Table 6—Personal Property Insurance

Table 7—Commercial Property Insurance

Table 8—Liability and Other Lines Insurance

Table 9—Automobile Insurance

B. NOTES ON PREPARATION OF ESTIMATED INCOME STATEMENTS

1. General Comments

Individual general insurance companies do not report the specific revenues and expenses relating to the various segments of their Ontario business. As a result, the income statements showing the operating results of the general insurance business in Ontario for the years 1973 to 1977 are labelled "estimated". Estimates are based on the information in the Annual Reports of the Ontario and Federal Superintendents of Insurance together with data from the S-9 Reports to the Ontario Superintendent concerning the Canada-wide operations of the reporting companies. Certain assumptions have been made in the preparation of the income statements to estimate the results of industry operations in Ontario. These assumptions and estimates were discussed with senior officials in the Office of the Superintendent and with officials of the Insurance Bureau of Canada who were satisfied that the data developed in this Appendix provided a realistic perspective on the profitability of the Ontario general insurance industry and of its product line segments.

Because Lloyd's is required to report only summary information concerning its operations in Canada and since the impact of its results on any conclusions concerning the general insurance industry in Ontario would be minimal, the business Lloyd's writes has been excluded from the estimated income statements. Also excluded are the results of the farm mutuals which are reported separately in Appendix E of this Report, together with the summary financial information available on Lloyd's.

In estimating operating results by major product line segments, extensive use has been made of the S-9 Reports. The general content and the bases of preparation of the S-9 Reports are set out below, followed by an explanation of the data sources and calculations corresponding to the revenue and expense items in the estimated income statements.

2. S-9 Reports

S-9 Reports must be filed annually with the Ontario Superintendent of Insurance by all general insurance companies licenced to do business in Ontario, with the exception of Lloyd's and the farm mutual insurance companies. The S-9 Reports reflect the operating results *by major product line* for all business written in Canada by companies licenced in Ontario, but they do not break out separately the business written in this Province. The Superintendent's Office consolidates the individual company reports to produce an "all companies" Report. The "all companies" Reports for the years 1973-1977 were used as a primary source of information in preparing the Ontario product line income statements. As well as profit and loss statements, the S-9 Reports include various supporting schedules.

The tabulation of the 1976 and 1977 "all companies" income statement was tested from the S-9 Reports of individual companies. Various procedures were used to confirm the accuracy and reliability of these S-9 Report summaries. The following sets out the general content and bases of S-9 preparation:

1. Net premiums written, net claims incurred and net commissions are reported for S-9 purposes net of both licenced and unlicenced reinsurance. It is understood that, for Federal reporting purposes, British and Foreign companies may not net out unlicenced reinsurance. If so, the impact of this difference on the total Canada-wide figures would be insignificant.
2. It is also understood that companies whose Accident and Sickness premium income is less than \$1,000,000 may report these premiums as Other Lines premium income. Once again, the impact on the results of operations in the Other Lines would be insignificant.
3. I.B.C. members allocate general expenses to product lines using the I.B.C. Expense Allocation programme. Non-members of I.B.C. may develop and use reasonable allocations.

4. The discounting of unearned premium reserves by up to 20%, to allow for deferred acquisition costs, must be the same as is used in the company's annual statement.
5. In allocating investment income to major product lines and equity, companies are encouraged to follow the I.B.C. allocation guidelines. Those companies not following the I.B.C. guidelines must state their basis of allocation. In general terms the I.B.C. guidelines are as follows:
 - a) Equity is increased (decreased) for over (under) reserving of unearned premiums and claims to arrive at adjusted equity.
 - b) Opening plus closing adjusted equity is divided by two to obtain an average equity for the year.
 - c) An average investment yield is calculated and applied to the average equity to determine the amount of investment income allocated to equity.
 - d) The difference between the actual investment income and the amount allocated to equity is the income to be allocated to the major product lines.
 - e) The product line income is then pro-rated among the classes using the average unearned premium reserves plus claims reserves for each class.

As noted, non-members of I.B.C. may develop and use reasonable allocations when completing the S-9 Report. Since premiums, losses and commissions generally can be associated directly with a product line, the use of "non-I.B.C." allocation methods affects only general expenses and investment income. On the whole, the S-9 Reports are representative of I.B.C. allocation methods in that I.B.C. members, as indicated in the introduction to this Appendix, are representative of the Ontario industry.

The notes which follow outline the sources of information and the assumptions made in allocating revenues and expenses to the major product line segments of the general insurance industry in Ontario, as shown in the estimated income statements in Tables 1 to 5.

3. Direct Premiums Written

The Annual Report of the Superintendent of Insurance for Ontario details, by company, the amount of direct premiums written in Ontario in various classes of general insurance. These amounts were grouped to determine, the direct premiums written by major class of insurance.

4. Net Premiums Written

Net premiums written is determined as follows: direct premiums written plus reinsurance assumed less reinsurance ceded equals net premiums written. Individual companies are not required to allocate the reinsurance

they assume or cede to their business written in each Province. In order to determine net premiums written in Ontario for each class of business, the percentage of net premiums written to direct premiums written was calculated from the Federal Superintendent's Annual Report for all Canada for each class of insurance. After discussions, it was assumed that these all Canada percentages apply to Ontario and, therefore, they were used to factor the Ontario direct premiums written to net premiums written.

5. Net Premiums Earned

From the S-9 Report and the Federal Superintendent's Annual Report, the percentage difference between net premiums earned and net premiums written for all Canada was calculated for each class of insurance. These percentages were applied to the Ontario net premiums written to estimate net premiums earned.

6. Net Claims and Adjustment Expenses Incurred

The Ontario Superintendent's Annual Report sets out direct claims incurred for each class of insurance written in Ontario. To arrive at net claims incurred for each class of insurance in Ontario, assumptions were made comparable to those made for net premiums written. Accordingly, the estimates of net claims and adjustment expenses incurred reflect differences between the Ontario and all Canada loss ratios.

7. Net Commission and General Expenses

The S-9 Report allocates net commission and general expenses to the various classes of insurance on an all Canada basis. Their respective percentages of net premiums earned for each class of insurance according to the S-9 Reports were used to calculate net commission and general expenses for Ontario for each product line. Inquiries were made regarding the impact on these estimates of the lower commission expense of direct writers, as well as the impact of Province to Province variations in commission rates. It was concluded that any differences would be immaterial.

8. Investment Income

The method used in the S-9 Reports to allocate investment income to the various classes of insurance and to equity on an all Canada basis was set out above. The intent of this method is to distinguish non-operating and operating investment income, that is, the portion of income attributed to investments financed, respectively, by equity and by premium and claims reserves.

The I.B.C. method of allocation, through its assignment of investment income first to equity, with the residual to product lines, assumes that all

assets other than investments are financed by premium and claims reserves.

The Committee expressed the view in its First Report that:

“insurers should be directed not to publicize their underwriting results as distinct from the results of their total operations, including any investment income. For greater clarity the Committee wishes to add that the investment income to be taken into consideration is not only that which is derived from unearned premiums, but also that which comes from the equity used in the business”.¹

In keeping with this view, data developed throughout this Appendix show product line profitability after an allocation for investment income based on the S-9 weighting used to allocate investment income to the various classes of insurance.

9. Income Taxes

As companies in the general insurance industry report taxes on the “flow through” or “taxes payable” basis, there is no logical way to allocate income tax to the various lines of business. Therefore, it is important to note that the product line profit or loss data in this Appendix are *before* income taxes.

10. Personal and Commercial Property

The split of property insurance operating results between personal and commercial lines for the years 1974 to 1977 was made using the I.B.C. Expense Allocation and Reporting System. In particular the all Canada direct expense report and the Ontario earned loss ratios for personal lines were used as set out below.

(a) Direct Premiums Earned

From the direct expense report, the all Canada ratios of personal and commercial property direct premiums written to total property direct premiums written were determined. These ratios were then applied to total Ontario property premiums earned to arrive at Ontario personal and commercial property direct premiums earned.

(b) Net Losses Incurred

Ontario earned loss ratios for personal lines were applied to Ontario personal lines direct premiums earned to determine net losses incurred in personal lines. Net losses incurred in commercial property lines were calcu-

1. *First Report on Automobile Insurance*, page 94.

lated as the difference between total Ontario property losses incurred and net losses incurred in Ontario personal lines.

(c) Net Commission and General Expenses

Both these expenses were calculated using the direct expense report. Assumptions were used comparable to those made for direct premiums earned.

(d) Investment Income

After discussion with various sources, it was assumed that investment income as a percentage of premiums earned would be the same for both personal and commercial lines. Accordingly, total Ontario investment income allocated to the property class was split on a pro-rata basis between the two lines.

C. ESTIMATED INCOME STATEMENT TABLES

Tables 1 to 5 which follow are related to:

Table 1—Property Insurance

Table 2—Liability Insurance

Table 3—Other Lines Insurance

Table 4—Personal and Commercial Property Insurance

Table 5—Automobile Insurance

D. NOTES ON RETURN ON EQUITY CALCULATIONS

1. Pre-Tax Return on Equity

General insurers do not segregate assets or liabilities, other than unearned premiums and certain reserves for outstanding claims, by lines of business written or by Province, if they are doing business in more than one Province. Nor do they prepare separate financial statements for each segment of their operations in Ontario. For these reasons, the capital and surplus (equity) applicable to each major class of Ontario general insurance were estimated. Both the all Canada profit before tax and average equity for 1976 and 1977 were also estimated. The assumptions made and procedures used to develop these estimates are outlined below.

a) All Canada

For the years 1973-1975 the average equity, profit and loss before taxes and pre-tax return on equity are as reported in the First Report on the automobile insurance industry.¹ Comparable all Canada data for 1976 and 1977 were estimated as follows:

1. *First Report on Automobile Insurance*, page 192.

APPENDIX D
Table 1

THE GENERAL INSURANCE INDUSTRY IN ONTARIO

ESTIMATED INCOME STATEMENTS

PROPERTY INSURANCE

YEARS ENDED DECEMBER 31, 1973 TO 1977
(\$'000's)

	1973	1974	1975	1976	1977
Direct Premiums Written	\$282,571	\$328,144	\$385,473	\$519,203	\$631,587
	102.1%	103.3%	103.9%	105.7%	108.2%
Net Premiums Written	\$276,759	\$317,661	\$371,003	\$491,204	\$583,571
	104.5	104.0	102.5	107.2	109.4
Net Premiums Earned	\$264,841	\$305,443	\$361,954	\$458,212	\$533,428
	100.0	100.0	100.0	100.0	100.0
Net Losses Incurred (including adjusting expenses)	159,370	211,324	218,948	270,504	290,359
	60.2	69.2	60.5	59.0	54.4
Net Commission Expense	56,146	64,143	72,752	95,766	109,352
	21.2	21.0	20.1	20.9	20.5
Premium Taxes	5,651	6,562	7,709	14,278	18,977
	2.1	2.1	2.1	3.1	3.6
General Expenses	51,290	61,857	70,111	81,030	95,483
	19.4	20.3	19.4	17.7	17.9
Investment Income	23,306	27,489	31,128	37,573	45,341
	8.8	9.0	8.6	8.2	8.5
Other Expense	(530)	(711)	(2,533)	(1,375)	(1,066)
	(.2)	(.2)	(.7)	(.3)	(.2)
Profit (Loss) before Income Taxes	\$15,160	\$11,665	\$21,029	\$32,832	\$63,532
	5.7	(3.8)	5.8	7.2	11.9

THE GENERAL INSURANCE INDUSTRY IN ONTARIO

ESTIMATED INCOME STATEMENTS

LIABILITY INSURANCE

YEARS ENDED DECEMBER 31, 1973 TO 1977
(\$'000's)

	1973	1974	1975	1976	1977
Direct Premiums Written	\$74,837	\$80,913	\$100,787	\$128,815	\$161,234
	101.2%	101.2%	103.0%	102.8%	105.1%
Net Premiums Written	\$73,950	\$79,953	\$97,851	\$125,306	\$153,407
	105.2	105.5	106.9	106.2	111.2
Net Premiums Earned	\$70,294	\$75,785	\$91,536	\$117,990	\$137,956
	100.0	100.0	100.0	100.0	100.0
Net Losses Incurred (including adjusting expenses)	36,745	36,572	51,847	71,106	107,863
	52.3	48.3	56.6	60.3	78.2
Net Commission Expense	14,761	15,687	18,581	24,187	27,453
	21.0	20.7	20.3	20.5	19.9
Premium Taxes	1,496	1,618	2,015	3,542	4,836
	2.1	2.1	2.2	3.0	3.5
General Expenses	13,969	15,358	17,574	20,646	23,452
	19.9	20.3	19.2	17.5	17.0
Investment Income	8,857	10,155	12,265	16,990	22,211
	12.6	13.4	13.4	14.4	16.1
Other Expense	—	(303)	(732)	(236)	(414)
	—	(.4)	(.8)	(.2)	(.3)
Profit (Loss) before Income Taxes	\$12,180	\$16,402	\$13,052	\$15,253	\$ (3,851)
	17.3	21.6	14.3	12.9	(2.8)

APPENDIX D
Table 3

THE GENERAL INSURANCE INDUSTRY IN ONTARIO

ESTIMATED INCOME STATEMENTS

OTHER LINES INSURANCE

YEARS ENDED DECEMBER 31, 1973 TO 1977
(\$'000's)

	1973	1974	1975	1976	1977
Direct Premiums Written	\$34,653	\$29,198	\$48,916	\$45,966	\$59,949
	104.6%	108.0%	106.2%	104.0%	116.1%
Net Premiums Written	\$33,129	\$36,294	\$46,060	\$44,188	\$51,630
	125.8	129.2	128.5	121.0	127.4
Net Premiums Earned	\$26,334	\$28,092	\$35,844	\$36,519	\$40,525
	100.0	100.0	100.0	100.0	100.0
Net Losses Incurred (including adjusting expenses)	10,638	22,774	23,577	20,654	26,277
	40.4	81.1	65.8	56.6	64.8
Net Commission Expense	4,213	4,663	5,412	5,623	6,767
	16.0	16.6	15.1	15.4	16.7
Premium Taxes	693	783	978	1,314	1,800
	2.6	2.8	2.7	3.6	4.4
General Expenses	5,364	5,650	8,807	7,926	7,821
	20.4	20.1	24.6	21.7	19.3
Investment Income	2,949	4,010	7,097	7,559	11,752
	11.2	14.6	19.8	20.7	29.0
Other Expense	—	(84)	(250)	(110)	(284)
	—	(.3)	(.7)	(.3)	(.7)
Profit (Loss) before Income Taxes	\$ 8,375	\$ (1,761)	\$ 3,917	\$ 8,451	\$ 9,328
	31.8	(6.3)	10.9	23.1	23.1

THE GENERAL INSURANCE INDUSTRY IN ONTARIO

ESTIMATED INCOME STATEMENTS

PERSONAL AND COMMERCIAL PROPERTY INSURANCE

YEARS ENDED DECEMBER 31, 1974 TO 1977
(\$'000's)

	1974			1975			1976			1977		
	Personal	Commercial	Total	Personal	Commercial	Total	Personal	Commercial	Total	Personal	Commercial	Total
Net Premiums Earned	\$128,286	\$177,157	\$305,443	\$145,867	\$216,087	\$361,954	\$199,322	\$258,890	\$458,212	\$248,577	\$284,851	\$533,428
Net Losses Incurred (including adjusting expenses)	80,820	130,504	211,324	89,562	129,386	218,948	130,157	140,347	270,504	142,186	148,173	290,359
Net Commission Expense	29,377	34,766	64,143	32,447	40,305	72,752	43,860	51,906	95,766	51,395	57,957	109,352
Premium Taxes	2,815	3,747	6,562	3,315	4,394	7,709	6,496	7,782	14,278	9,128	9,849	18,977
General Expenses	26,537	35,320	61,857	30,147	39,964	70,111	36,869	44,161	81,030	45,927	49,556	95,483
Investment Income	11,247	15,531	26,778	11,524	17,071	28,595	15,747	20,451	36,198	20,632	23,643	44,275
Profit (Loss) Before Income Taxes	\$ (16)	\$ (11,642)	\$ (11,665)	\$ 1,920	\$ 19,102	\$ 21,022	\$ (2,313)	\$ 35,145	\$ 32,832	\$ 20,573	\$ 42,959	\$ 63,532

THE GENERAL INSURANCE INDUSTRY IN ONTARIO

AUTOMOBILE INSURANCE

ESTIMATED INCOME STATEMENTS

YEARS ENDED DECEMBER 31, 1973 TO 1977
(\$'000's)

	1973	1974	1975	1976	1977
Direct Premiums Written	\$541,737	\$627,236	\$804,502	\$958,412	\$1,086,379
Net Premiums Written	\$555,058	\$642,002	\$825,977	\$969,072	\$1,075,392
Net Premiums Earned	\$545,780	\$622,698	\$746,814	\$903,984	\$1,041,037
Net Losses Incurred (including adjusting expenses)	404,136	499,907	576,023	666,096	752,292
Net Commission Expense	69,314	79,705	98,579	113,902	127,006
Premium Taxes	10,834	12,544	16,090	26,356	32,519
General Expenses	74,226	89,668	100,820	112,094	129,088
Investment Income	52,940	64,760	75,428	94,014	113,473
Other Expense		(1,868)	(2,987)	(904)	(4,164)
Profit (Loss) before Income Taxes	\$ 40,210	\$ 3,766	\$ 27,743	\$ 78,646	\$ 109,441
	7.4	.6	3.7	8.7	10.5

- a) The increase in average equity from year to year was assumed to equal the after-tax profit reported in the 1976 and 1977 S-9 Reports. The effects of other possible changes in equity in these two years were not reflected in the calculations, since there is no practical method readily available to estimate a reduction in equity for dividends paid and withdrawals of capital, or to estimate increases in equity from infusions of new capital.
- b) Profit before taxes was assumed to be the same as reported in the 1976 and 1977 S-9 Reports.
- c) The data for the five years 1973 to 1977 were averaged.

b) Property, Casualty and Other Lines

For each of the years 1973-1977 average equity was calculated as the ratio of premiums earned in Ontario to premiums earned in all Canada. The data for the five years were then averaged.

c) Ontario Automobile

The First Report¹ on the automobile insurance industry provided estimates for the years 1971 to 1975 of the average equity, profit and loss before taxes and pre-tax return on equity for the Ontario segment of the automobile insurance industry. The First Report did not provide comparable estimates for 1976 and 1977.

In order to provide a consistent time frame for comparing automobile insurance estimates of return on equity with the non-automobile estimates provided in this Report, the financial data for the Ontario automobile insurance industry were calculated for the years 1976 and 1977 using the assumptions previously outlined in this Appendix. Further, since this Report has made certain refinements in the assumptions used in the First Report, the automobile estimates of profitability and return on equity for the years 1973 to 1975 were amended using the assumptions previously outlined in this Appendix.

This Report provides, therefore, estimates of the financial results of the automobile segment of the industry in Ontario for the years 1973 to 1977 prepared on a consistent basis with the financial estimates provided for the non-automobile insurance segment.

2. After-Tax Return on Equity

The after-tax rate of return on equity was calculated as follows:

- a) Annual all Canada effective tax rates as reported in the 1973 to 1977 S-9 Reports were calculated.

1. *First Report on Automobile Insurance*, page 192.

- b) These tax rates were applied to reduce the pre-tax average equity and pre-tax profits to arrive at estimated after-tax profits and equity.
- c) The after-tax profits were then divided by the after-tax equity to arrive at the after-tax rate of return on equity.

E. NOTES ON PREPARATION OF ESTIMATED OPERATING COST PROFILE

Data on the operating expenses of the general insurance industry in Ontario by individual line of business are not segregated by individual companies in reporting their operating results. Accordingly, numerous assumptions and estimations are necessary to develop this information.

For the most part, the estimated operating cost data in this Appendix are prepared from the same information sources as used for the income statements of the general insurance industry in Ontario. In addition and through the cooperation of the Insurance Bureau of Canada, the operating statistics produced by the I.B.C. Expense Allocation and Reporting System have provided the bases for most assumptions and estimates on cost allocations between the major product lines. In the absence of other sources of detailed information, the I.B.C. statistics have been taken as representative of the Ontario industry.

In reviewing the operating cost profiles that are included in Tables 6 to 9 in this Appendix, the following considerations are significant:

- The operating ratios in Tables 6 to 9 are based on the estimated income statements included earlier as Tables 1 to 5 in this Appendix and therefore are subject to the same assumptions and are prepared from the same information sources as outlined earlier in Section B.
- The “Liability” and “Other Lines” estimated income statements as previously presented have been combined so as to present a total estimated income statement for these two major categories. The I.B.C. Expense Allocation and Reporting System does not permit the identification of detailed operating costs, segregated between these lines. Therefore, in order to use the I.B.C. system as the information base to analyze operating costs further by their functional components, it was necessary to combine “Liability” and “Other Lines” and recompute operating ratios for the combined category of insurance.
- The statistics shown for automobile insurers are provided for comparative purposes.
- Detailed estimates of adjusting costs by major lines of coverage have not been determined.

F. ESTIMATED OPERATING COST PROFILE TABLES

Tables 6, 7, 8 and 9 which follow are related to:

Table 6—Personal Property Insurance

Table 7—Commercial Property Insurance

Table 8—Liability and Other Lines Insurance

Table 9—Automobile Insurance

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING COST PROFILE
PERSONAL PROPERTY, 1974-1977

	1974-1977 Annual Average Percentage	Allocation by Detailed Components	Allocation by Functional Operating Cost Components			Total
			Acquisition	Underwriting & Policy Processing	Claims Adjusting	
Premiums Earned	100.0%	100.0%				
Claims Incurred	61.3	61.3			*	
— Direct Cost of Claims Incurred	21.7	21.7%	21.7%			
Commission Expense	3.0	3.0	3.0			
Premium Tax	19.3					
General Expenses						
— Agent Service & Promotion		2.4	2.4			
— Underwriting/Policy Processing		9.4		9.4%		
— Claims Adjusting Administration		2.5			2.5%	
— General Administration		5.0	.7	3.3	1.0	
Total Operating Costs		44.0%	27.8%	12.7%	*3.5%	*44.0%
Investment Income and Other Expense	(8.2)	(8.2)				(8.2)
Profit Before Income Taxes	2.9%	2.9%				*35.8%
			Total Net Operating Costs			

* Plus adjusting costs charged directly to the claims file.

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING COST PROFILE
COMMERCIAL PROPERTY, 1974-1977

	1974-1977 Annual Average Percentage	Allocation by Detailed Components	Allocation by Functional Operating Cost Components		
			Acquisition	Underwriting & Policy Processing	Claims Adjusting
Premiums Earned	100.0%	100.0%			
Claims Incurred					
— Direct Cost of Claims Incurred	58.5	58.5			*
Commission Expense	19.7	19.7%	19.7%		
Premium Tax	2.7	2.7	2.7		
General Expenses	18.0				
— Agent Service & Promotion		2.4	2.4		
— Underwriting/Policy Processing		9.8		9.8%	
— Claims Adjusting Administration		1.6			1.6%
— General Administration		4.2	.7	3.0	.5
Total Operating Costs		40.4%	25.5%	12.8%	*2.1%
Investment Income and Other Expense	(8.2)	(8.2)			
Profit Before Income Taxes	9.3%	9.3%			
			Total Net Operating Cost		
					(8.2)
					*32.2%

* Plus adjusting costs charged directly to the claims file.

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING COST PROFILE
LIABILITY AND OTHER LINES, 1973-1977

	1973-1977 Annual Average Percentage	Allocation by Detailed Components	Allocation by Functional Operating Cost Components			Total
			Acquisition	Underwriting & Policy Processing	Claims Adjusting	
Premiums Earned	100.0%	100.0%				
Claims Incurred						
— Direct Cost of Claims Incurred	61.7	61.7			*	
Commission Expense	19.3	19.3%	19.3%			
Premium Tax	2.9	2.9	2.9			
General Expenses	19.1					
— Agent Service & Promotion		2.5	2.5			
— Underwriting/Policy Processing		9.6		9.6%		
— Claims Adjusting Administration		2.1			2.1%	
— General Administration		4.9	.9	3.1	.9	
Total Operating Costs		41.3%	25.6%	12.7%	*3.0%	*41.3%
Investment Income and Other Expense	(15.4)	(15.4)				(15.4)
Profit Before Income Taxes	12.4%	12.4%				*25.9%
Total Net Operating Cost						

* Plus adjusting costs charged directly to the claims file.

THE GENERAL INSURANCE INDUSTRY IN ONTARIO
ESTIMATED OPERATING COST PROFILE
AUTOMOBILE, 1973-1977

	1973-1977 Annual Average Percentage	Allocation by Detailed Components	Allocation by Functional Operating Cost Components		
			Acquisition	Underwriting & Policy Processing	Claims Adjusting
Premiums Earned	100.0%	100.0%			
Claims Incurred	75.1	75.1			*
— Direct Cost of Claims Incurred					
Commission Expense	12.7	12.7%	12.7%		
Premium Tax	2.5	2.5	2.5		
General Expenses	13.1				
— Agent Service & Promotion		1.7	1.7		
— Underwriting/Policy Processing		5.2		5.2%	
— Claims Adjusting Administration		2.6			2.6%
— General Administration		3.6	1.0	2.1	.5
Total Operating Costs		28.3%	17.9%	7.3%	*3.1%
Investment Income and Other Expense	(10.2)	(10.2)			*28.3%
Profit Before Income Taxes	6.8%	6.8%			(10.2)
			Total Net Operating Cost		*18.1%

* Plus adjusting costs charged directly to the claims file.

APPENDIX E

(referred to in Chapter 3)

DESCRIPTION AND OPERATING RESULTS OF FARM MUTUALS AND LLOYD'S

A. FARM MUTUALS

Farm mutual fire insurance companies originated over 100 years ago to write fire insurance for farms in their local communities. Each policyholder of a farm mutual is a member of the company and has one vote in its affairs. Due primarily to amalgamation, the number of mutuals has been declining over the past 40 years.

Farm mutuals are restricted under Section 169 of The Corporations Act to insuring "Agricultural property or property that is not mercantile or manufacturing or hazardous". They are further restricted in the class of insurance they write to the following: property insurance, liability insurance, hail insurance, weather insurance and automobile insurance. All coverages listed after property insurance can only be written for property insureds. Therefore, present legislation restricts farm mutuals from insuring those risks in their own community which are not primarily of an agricultural nature. Other limitations on farm mutuals are imposed under the Insurance Act and by guidelines, such as those which interpret the definition of agricultural property, set by the Superintendent of Insurance.

Until a few years ago farm mutuals used premium notes, whereby the insured promised to pay additional premiums should his farm mutual company have claims in excess of premiums earned. The premium note was a method of guaranteeing the solvency of the farm mutual company. To eliminate the premium note requirement, a \$1,000,000 Farm Mutuals Guarantee Fund was established in 1976. The fund is intended to guarantee the solvency of every farm mutual. It operates by an assessment on all farm mutuals and may be drawn upon only in the event of a mutual going into bankruptcy. In this situation, the guarantee fund would pay the creditors' shortfall, the defaulting organization would cease to exist and each of the remaining farm mutuals would be assessed to replenish the fund.

The mutuals are subject to the following Ontario Department of Insurance "in-house" solvency tests:

- (a) premiums written should not exceed surplus;
- (b) unearned premium reserves at 100% should not exceed 50% of surplus.

These tests are twice as restrictive as those applied to joint stock companies. It is the opinion of the Office of Superintendent that this is necessary since there is no share capital in farm mutuals and, therefore, undistributed profits are the only source of new capital.

FARM MUTUAL INSURANCE COMPANIES IN ONTARIO
ESTIMATED INCOME STATEMENT
YEARS ENDED DECEMBER 31, 1973 TO 1977
(\$'000's)

	1973	1974	1975	1976	1977
Direct Premiums Written					
Property	\$11,337	\$13,153	\$15,557	\$18,822	\$22,143
Wind	830	1,200	1,699	2,439	3,175
Liability	331	474	687	958	1,544
Hail	160	256	187	30	53
	<u>\$12,658</u>	<u>\$15,083</u>	<u>\$18,130</u>	<u>\$22,249</u>	<u>\$26,915</u>
Net Premiums Written	<u>\$10,200</u>	<u>\$11,997</u>	<u>\$17,340</u>	<u>\$18,845</u>	<u>\$21,610</u>
Net Premiums Earned	\$ 9,642	\$11,371	\$14,672	\$17,098	\$19,817
	100.0%	100.0%	100.0%	100.0%	100.0%
Net Claims Incurred	5,328	6,205	7,396	8,346	10,111
	55.3	54.6	50.4	48.9	51.0
Net Adjusting Expense	116	149	213	264	300
	1.2	1.3	1.4	1.5	1.5
Commission Expense	1,190	1,429	2,518	2,633	3,176
	12.3	12.6	17.2	15.4	16.0
General Expense	1,624	1,987	2,322	2,719	3,237
	16.9	17.5	15.8	15.9	16.4
Fire Prevention Expense	111	141	168	206	276
	1.1	1.2	1.2	1.2	1.4
	<u>8,369</u>	<u>9,911</u>	<u>12,617</u>	<u>14,168</u>	<u>17,100</u>
Underwriting Profit (Loss)	1,273	1,460	2,055	2,930	2,717
	13.2	12.8	14.0	17.1	13.7
Net Investment Income	1,883	2,357	2,873	3,687	4,547
	19.5	20.7	19.6	21.6	22.9
Net Profit	<u>\$ 3,156</u>	<u>\$ 3,817</u>	<u>\$ 4,928</u>	<u>\$ 6,617</u>	<u>\$ 7,264</u>
	<u>32.7%</u>	<u>33.5%</u>	<u>33.6%</u>	<u>38.7%</u>	<u>36.6%</u>

Farm mutuals do not pay the 3% premium tax and are not subject to income taxes. Any insurer writing 50% or more of its business for farmer or fishermen policyholders is exempt from income tax under the federal Income Tax Act.

The Farm Mutual Reinsurance Plan Inc. (F.M.R.) was established in 1959 and is owned by the farm mutuals. All farm mutuals have agreed to re-insure only through F.M.R. One major reinsurance treaty, which applies to all farm mutuals, has been established for each line of business. Under existing treaties, farm mutuals may write individual risks up to approximately \$400,000. Above this level F.M.R. will retrocede to general reinsurance companies. Under Section 168 of The Corporations Act, the reinsurance plan of farm mutuals is permitted to reinsure only with an insurer licenced in the Province and to reinsure only contracts entered into by its members.

When a farm mutual has accumulated \$1,000,000 in surplus it may apply for supplementary letters patent designating it as a cash mutual. As a cash mutual it may write all types of general insurance, including mercantile risks. The Wawanesa Mutual Insurance Company is an example of a farm mutual which became a cash mutual.

An annual independent audit of the financial affairs of each farm mutual is required in addition to periodic examinations by the Superintendent's Office. The Ontario Superintendent of Insurance requires each farm mutual to supply income statement information annually.

The estimated income statement in Table 1 facing shows the Ontario insurance operations of farm mutuals for the five years ended December 31, 1973 to 1977. The data in Table 1 are summarized below for the five year period, 1973-1977.

TABLE 2
 FARM MUTUAL INSURANCE COMPANIES IN ONTARIO
 ESTIMATED OPERATING RESULTS, FIVE YEAR AVERAGE, 1973-1977
 (\$ millions)

	Total 1973-1977	Annual Average 1973-1977	Percentage of Premiums Earned
Premiums earned	\$72.6	\$14.5	100.0%
Claims incurred	\$37.4	\$ 7.5	51.7%
Adjusting expenses	1.0	.2	1.4
Commission expense	10.9	2.2	15.2
Fire prevention expense	.9	.2	1.4
General expense	11.9	2.4	16.5
Investment income	(15.3)	(3.1)	(21.4)
	\$46.8	\$ 9.4	64.8%
Net Profit	\$25.8	\$ 5.1	35.2%

and indicates for this period, that:

FARM MUTUAL REINSURANCE PLAN INC.
INCOME STATEMENT
YEARS ENDED DECEMBER 31, 1973 TO 1977
(\$'000's)

	1973	1974	1975	1976	1977
Net premiums earned	<u>\$2,625</u>	<u>\$3,473</u>	<u>\$2,893</u>	<u>\$3,918</u>	<u>\$5,752</u>
Premiums retroceded	498	761	274	357	680
Net claims incurred	1,042	1,479	2,058	2,487	3,584
Net commission expense	387	569	273	736	1,086
General expense	<u>102</u>	<u>114</u>	<u>144</u>	<u>156</u>	<u>172</u>
			5.0	4.0	3.0
			95.0	95.4	96.0
Net investment income	<u>420</u>	<u>494</u>	<u>822</u>	<u>813</u>	<u>998</u>
			28.4	20.8	17.3
Provision for refund from surplus	<u>1,016</u>	<u>1,044</u>	<u>966</u>	<u>995</u>	<u>1,228</u>
			33.4	25.4	21.3
Net income	<u>\$ 430</u>	<u>\$ 473</u>	<u>\$ 531</u>	<u>\$ 995</u>	<u>\$1,228</u>
			18.4%	25.4%	21.3%

1. Of every \$1.00 of premium earned 53.1¢ was used to settle and adjust claims. Of this, 1.4¢ cover the costs of adjusting claims. The adjusting cost is significantly lower than for general property insurance since most claims are settled without the use of outside adjusters.
2. Commissions accounted for 15.2¢ of each premium dollar. This compares with 20.7¢ for property insurance written by property and casualty insurance companies. The lower commissions are said to be due to the use by certain farm mutuals of salaried personnel to write their insurance.
3. Fire prevention expense accounted for 1.4¢ of each premium dollar and includes the cost of fire inspectors which several of the mutuals employ.
4. General expenses absorbed 16.5¢ of each premium dollar.
5. The foregoing costs were offset by investment income equivalent to 21.4¢ for each \$1.00 of premiums. Investment income reduced net costs and expenses to 64.8¢ and left a profit of 35.2¢ for each dollar of premiums earned.
6. Investment income as a percentage of premiums earned is higher than for the general insurance industry as a whole. This is due in part to the more restrictive solvency tests imposed on farm mutuals.
7. The average return on premiums earned is approximately 30% higher than that earned by the general insurance industry in total on property insurance. The expansion and growth into new product lines has been made possible by this high return, which has ensured at the same time that the farm mutuals continue to meet the solvency requirements set out by the Superintendent's Office.

The income statement in Table 3 facing shows the operations of the Farm Mutual Reinsurance Plan Inc. as audited for the five years ended December 31, 1973 to 1977. The data in Table 3 are summarized below for the five year period, 1973-1977.

TABLE 4
FARM MUTUAL REINSURANCE PLAN INC.
OPERATING RESULTS, FIVE YEAR AVERAGE, 1973-1977
(\$ millions)

	Total 1973-1977	Annual Average 1973-1977	Percentage of Premiums Earned
Premiums earned	\$18.7	\$3.7	100.0%
Premiums Retroceded	\$ 2.6	\$.5	13.5%
Claims Incurred—Net	10.6	2.1	56.7
Commission Expense	3.0	.6	16.2
General Expense	.7	.1	2.7
Investment income	(3.5)	(.7)	(18.9)
	\$13.4	\$2.6	70.2%
Provision for refund from surplus	\$ 1.6	\$.3	8.1%
Net Profit	\$ 3.7	\$.8	21.7%

B. LLOYD'S

As mentioned in Chapter 4 to this Report, business placed at Lloyd's is not included in the estimated income statements. As Lloyd's operates in Canada by special agreement with the Provinces, it is required to file details of its underwriting accounts and investments held in Canada. Lloyd's has no office in Canada, but instead uses various brokers to act on its behalf.

LLOYD'S UNDERWRITING ACCOUNT IN CANADA—ALL BUSINESS, 1976 (\$000's)

Net Premiums Written	\$200,106
Add Reserve for Unearned Premiums at Beginning of year (80%)	<u>60,767</u>
	\$260,873
Less Reserve for Unearned Premiums at End of Year (80%)	<u>66,271</u>
Net Premiums Earned	\$194,602
Net Claims Incurred	133,698
Commissions	50,506
Taxes	4,766
Other Expenses	9,734
	\$198,704
<i>Underwriting Gain (Loss)—1976</i>	\$ (4,102)
—1975	\$(15,157)
—1974	\$(15,093)
—1973	\$ (1,586)
—1972	<u>\$ 4,276</u>

The following is a summary of direct premiums written and direct claims incurred at Lloyd's in property and casualty insurance (not including automobile) for Ontario and Canada for the years 1973 to 1977.

**PROPERTY AND CASUALTY INSURANCE WRITTEN
AT LLOYD'S, ONTARIO AND CANADA, 1973-1977**

(In Thousands of Dollars)

	Ontario		Canada	
	Direct Premiums Written	Direct Losses and Adjustment Expense Incurred	Direct Premiums Written	Direct Losses and Adjustment Expense Incurred
<i>Property</i>				
1977	\$15,685	\$10,118	\$ 95,142	\$62,088
1976	17,785	11,182	105,361	66,042
1975	16,113	9,812	76,838	54,731
1974	11,752	2,698	55,587	42,869
1973	8,586	8,618	44,524	28,968
<i>Liability</i>				
1977	\$ 7,755	\$11,653	\$ 16,345	\$15,937
1976	5,115	4,055	13,268	13,742
1975	4,379	1,893	9,806	8,553
1974	3,712	1,492	8,741	7,226
1973	3,254	465	6,623	6,432
<i>Other</i>				
1977	\$ 638	\$ 217	\$ 11,129	\$ 5,519
1976	2,036	2,172	5,852	13,908
1975	1,197	469	4,961	5,312
1974	716	634	3,433	5,791
1973	606	234	3,875	3,024

APPENDIX F

(referred to in Chapter 3)

DESCRIPTION OF PRODUCT LINES IN THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

This Appendix provides a more detailed definition and explanation of the types of insurance included under the three basic categories of property and casualty insurance reported upon in this Report:

- personal property insurance;
- commercial property insurance;
- liability insurance, including surety and fidelity;
- “other lines” of insurance

A. PERSONAL PROPERTY INSURANCE

There is no single, standard policy for personal property coverage marketed by the insurance industry. The basic coverage traditionally provided by the insurance industry to the individual is a “fire” policy insuring the home and the contents of the home against physical damage from the perils of fire, lightning and explosions of specific types.

Extensions of this coverage are provided for protection from other perils threatening physical damage, such as windstorm, hail, and malicious damage or vandalism. Further coverages can be added against loss of possessions, for example by theft, without physical damage necessarily occurring. The build-up of coverages can be continued by adding protection against indirect losses, such as extra living expenses incurred because the homeowner must move into rented premises until his home is repaired.

Finally, the homeowner may realize that he can suffer serious financial losses arising out of his liability in an accident on his premises, or as a result of use of his property. He may wish to purchase liability insurance coverage to protect himself against such losses.

The above steps in building up a total coverage package for the individual are outlined again below.

Steps in Total Coverage for Individuals

1. Basic Fire policy
2. Extended coverage for physical damage
3. Extended coverage for other loss of property

Coverage For:

- damage to dwellings, other buildings and contents
- damage to dwellings, other buildings and contents
- theft of personal property

- | | |
|---|---|
| 4. Coverage for certain indirect losses | — additional living expenses
— removal of debris
— loss of rent |
| 5. Liability coverage | — payments to a third party |

Comments follow below regarding the types of personal line policies marketed by the insurance industry in Ontario to provide these various levels of coverage.

The above mentioned coverages can be sold individually or in a “package”. Packages are designed for customer convenience and protection, by providing all basic or so-called “popular” coverages in one policy rather than in individual policies. Packages are also designed to be sold at lower cost, thereby being of added advantage to the customer. Their cost is lower because they simplify the insurer’s policy-issuing, underwriting and record-keeping procedures. Individual coverages for personal property or personal liability can be purchased separately from Ontario insurers but are not common forms and may not be equally available from all insurers. The most widely used “package” is the homeowner’s policy. The coverages in a homeowner’s package are subject to a discount in price.

There is no uniform, standard homeowner’s policy, but homeowner’s policies typically share the characteristics shown in Table 1. Habitational policies are typically divided into a policy section which covers property and a second policy section which covers liability. The property insured and the perils insured against are typically those shown in Table 1.

There are basically two variations in the “form” of the policy, “form” referring to the perils insured against:

- (a) some policies insure only against those perils specified in the policy;
- (b) other policies insure against “all risks of direct physical loss”, except those specifically excluded.

The more comprehensive form is the second type; however, it can still exclude numerous perils unknown to the policyholder who has not read the fine print.

Most companies market a number of homeowner’s forms. Several reasons can be found for the variety of forms:

- (a) Marketing advantages—to distinguish policies from those of competitors.
- (b) Consumer needs—to suit homeowners’ preferences for different coverages at different costs.
- (c) Underwriting reasons—to lessen the insurers’ liability for large losses by selling more restrictive coverages or forms.

TABLE 1

HABITATIONAL POLICIES - SUMMARY OF PACKAGE COVERAGES

POLICY SECTION I (Property Coverage)			
Coverage "A"	Coverage "B"	Coverage "C"	Coverage "D"
Home or Dwelling Building	Garage or Appurtenant Private Structures	Contents or Personal Property	Additional Living Expense
The amount under this coverage is chosen as the basic contract coverage.	Basic coverage at 10% of home amount.	a) On premises. Basic coverage at 40% of home amount. b) Away from premises. Basic coverage at 10% of home amount, with \$1,500 minimum.	Basic coverage at 20% of home amount.
Common Forms Specifying Insured Perils			
1. Homeowners Basic	All coverages in Section I are against specified perils as follows: fire or lightning, extended coverage perils (windstorm or hail, explosion, falling object, glass breakage, impact by aircraft or land vehicle, riot, water escape, rupture, freezing, smoke), transportation, theft, vandalism.		
2. Homeowners Limited	All coverages in Section I are against specified perils as in the Basic form above except for: glass breakage, transportation, theft.		
3. Homeowners Broad	Coverages A, B and D of Section I are against "all risks of direct physical loss", except for those specifically excluded, such as flood, earthquake, damage by vermin or insects, backing up of sewers, and so on.		
4. Homeowners Comprehensive	Coverage C on contents is against specified perils in the Basic form above, except for glass breakage.		
5. Tenants Package*	All coverages in Section I are against "all risks of direct physical loss", except for those specifically excluded as in the Broad form above. Only coverages C and D of Section I are applicable. These coverages are against specified perils as in the Basic homeowners form above, except for glass breakage. If coverage is "limited", theft is excluded. *Applicable to condominium owners as premises are normally covered under a building policy.		
6. Mobile Homeowners	All coverages under Section I are against specified perils as in the Basic homeowners form above. If coverage is limited, glass breakage and theft is excluded.		

POLICY SECTION II
(Liability Coverage)

Coverages "E", "F", and "G"

All forms shown include these coverages.

Coverage E:

- (1) Comprehensive Personal Liability
- covers, to the limit contracted, the legal liability of the insured to pay damages because of bodily injury or property damage.

(2) Fire Legal Liability

- covers, to the limit contracted, the legal liability of the insured to pay damages because of damage from fire, explosion or smoke, to property rented to, or in the care, custody or control of the insured.

Coverage F:

Voluntary Medical Payments (non-liability)

- provides medical payments that apply to injuries of others even in those cases in which the insured is not legally liable. Any person injured within the scope of this coverage can collect benefits.
- reasonable medical expenses including funeral expense incurred within one year of the date of the accident.
- standard limit: \$500.

Coverage G:

Voluntary Payment for Damage to Property (non-liability)

- pays for damage to the property of others that is caused by an insured regardless of whether the insured is legally liable. Property must be actually damaged or destroyed.
- limit of liability typically does not exceed \$500 in any one occurrence.

Individual insurers' policies also vary generally with respect to the following factors:

- (a) Types of property and losses *covered*. For example, a company may include coverage for stereo tapes away from the premises.
- (b) Types of property or losses *excluded*. For example, a company may exclude loss of a credit card in all its policy forms, while other companies may include this coverage up to a stated limit.
- (c) Events or perils insured against. For example, a company may exclude glass breakage, usually treated as a peril, from all its policy forms, requiring instead a separate endorsement.
- (d) Amounts covered. Variation is most common with respect to coverage for unscheduled property. Companies vary typically on the limit of liability assumed in the main policy for items such as stamp collections, money losses and so on. For example, one company may place a \$250 limit on jewellery, another may place \$500 or \$1,000.

Policies do not normally vary greatly with respect to the insuring agreement, the conditions or the definitions of that agreement.

In addition, there are endorsements or floater forms that can be attached to the basic package policy. They are normally written by the personal property insurer. Examples are the Fine Arts Form and the Personal Articles Floater Form covering those classes of property scheduled on these forms. Coverage is provided to the amount stated on the policy. Personal property forms which schedule the property to be insured are sometimes identified as "inland marine" policies. These policies differ from normal unscheduled property coverages by providing: (a) all risks cover; (b) inclusion of flood with other perils; and (c) inclusion of earthquake deductibles and rating where required.

B. COMMERCIAL PROPERTY INSURANCE

The basic commercial property insurance contract covers buildings, permanent fixtures, machinery and other related property against losses from fire and other named perils. Various endorsements or special forms cover differing types of properties against increased numbers of perils. There are a multitude of different contracts, usually classified under fire and allied lines of insurance, providing this basic property coverage to the commercial buyer. In addition, there are many other important types of business property insurance available, including business interruption insurance, crime insurance, cargo insurance and boiler and machinery insurance. These major property coverages and some miscellaneous coverages are described below, excluding boiler and machinery insurance which is considered as part of the "other lines" category.

1. Fire and Allied Lines

Coverage for commercial risks starts with a basic policy insuring building, equipment and contents against the perils of fire, lightning and explosion of specific types. Only direct losses from physical damage are covered.

This basic policy is usually extended by one of two options, namely *Extended Coverage* or *All Risks*. The Extended Coverage endorsement insures against specific additional perils such as impact by aircraft or land vehicle, lightning damage to electrical devices, smoke, riot, leakage from fire-protection equipment, windstorm, hail, and malicious damage or vandalism.

The All Risks endorsement insures against all perils except those that are specifically excluded. The main difference between the two types of endorsements is that the All Risks form provides coverage for risks such as water escaping from plumbing, theft and roof collapse. In addition, All Risks is more common for situations such as buildings under construction and property in transit where the chances of damage are greater; whereas Extended Coverage is most often bought for "static" property, such as buildings, equipment and contents. All Risks policies are not standard as are Fire and Extended Coverage (Fire & E.C.) policies.

The basis of valuation under Fire & E.C. and All Risks policies is actual cash value (A.C.V.), that is, the cost of replacement less physical depreciation. For an additional premium, replacement cost value (R.C.V.) insurance can usually be bought. However, the R.C.V. policy will only pay replacement cost if, in fact, a replacement is made, and in the case of buildings on the same or an adjacent site.

The fire policy protects stock (inventory) against loss from physical damage as well as buildings, equipment and other contents. However, the quantity and value of stock may vary widely over the year. Hence, an option is the purchase of adjustable stock insurance. Under this plan an adequate maximum amount of insurance is set and a deposit is paid. Actual values of inventory are then declared to the insurance company, usually monthly. The amounts declared are averaged over the year and the premium adjusted.

Allied lines is a term used to describe coverages closely associated with, and usually sold in conjunction with, fire insurance. They include generally:

1. Sprinkler leakage
2. Water damage
3. Earthquake
4. Radioactive contamination
5. Standing timber
6. Rain insurance

Unlike dwelling policies, commercial fire policies do not provide coverage for consequential or indirect loss resulting from damage to the insured property. The major form of consequential loss coverage is business interruption insurance which is sometimes provided by endorsement to the fire policy, but is also commonly provided in a separate policy as described below.

2. Business Interruption

Business interruption insurance is defined as insurance covering the loss of earnings resulting from and occurring after destruction of property. Three types of policies are available:

(a) Gross Earnings

- Pays the amount of net profit before taxes that the business would have earned had it not been interrupted. Payments stop when the damaged premises are rebuilt or the machinery is repaired. This type of policy excludes loss of earnings due to damage to finished stock.

(b) Profit

- Pays the amount of gross profit loss as a result of an insurable business interruption. Payment can extend beyond the time that damages are made good to allow the business to return to normal. There is no exclusion for finished stock.

(c) Extra Expense

- Provides coverage for the necessary expense of maintaining the normal standard of operations in order to keep up business, even though such interim operations are uneconomical or do not yield a profit.

3. Crime Insurance

Crime insurance is frequently marketed as a Comprehensive Dishonesty, Disappearance and Destruction (“3-D”) Policy which is a combination of coverages for fidelity, forgery and loss of money and securities. The premium is a summation of the individual premiums for the separate coverages.

There are five insuring agreements under the typical contract. The insured can opt for any or all of the following coverages:

- (a) Employee dishonesty;
- (b) All risk coverage on money or securities on the premises;
- (c) Loss of money or securities while being conveyed by a messenger outside the premises;

- (d) Loss of securities from a safety deposit box; or
- (e) Loss caused by forgery on outgoing instruments (e.g. cheques).

Many options can be added to the policy.

Many other types of policies are available in addition to the Comprehensive policy, each covering a specified area. Two broad types are non-employee crime insurance, described below, and employee dishonesty insurance or fidelity bonds described as part of the Laibility category.

Many types of non-employee crime or burglary and robbery policies are available, each designed to afford protection against designated perils for specified types of property. A few of these follow:

- (a) “Mercantile Open-Stock Burglary” covers loss of merchandise, furniture, fixtures or equipment as a result of burglary (defined as abstraction of goods by means of forcible entry or exit).
- (b) “Mercantile Open-Stock Theft” covers losses incurred through theft (defined as abstraction of goods by any illegal means—including burglary or robbery).
- (c) “Mercantile Safe Burglary” covers losses of any property from a safe or vault by means of forcible entry without the requirement that premises be entered forcibly.
- (d) “Mercantile Robbery” covers losses of property as a result of robbery (defined as taking of property by violence inflicted upon a custodian or putting him in fear of violence or by any overt act committed in the presence of the custodian of which he is actually cognizant). There are two separate, independent sections of the policy—robbery outside or robbery inside premises. The insured can opt for either or both.

4. Cargo Insurance

Cargo insurance as part of the property insurance category excludes marine insurance contracts normally termed as ocean marine insurance. The modes of transportation included under the cargo insurance definition include railroad, motor truck, air and sometimes incidental water transportation. The trucker, railroad or airline may be a common carrier with extensive liability as a bailee and a recognized duty of care normally supported by a written statement in the transportation contract or bill of lading. Nevertheless the shipper may still require cargo insurance to increase the limits of recovery under the bill of lading, to facilitate collection or to extend recovery to perils such as an act of God, exercise of public authority or inherent defects which are not covered under the common carriers’ liability.

Cargo insurance contracts are generally tailored to the insured’s needs and consequently are of many forms and types.

5. Miscellaneous Property Coverages

Crop insurance covers damages to crops arising from fire, hail, excessive rain, lightning, windstorm, aircraft, smoke and other miscellaneous perils such as frost and freezes. Separate plans are offered for different crops and against different perils. Some private insurers provide coverage but the bulk of coverage is provided by the Ontario Crop Insurance Commission in the Ontario Ministry of Agriculture. The federal government provides a subsidy to growers for half of the premium, for insurance written with the Ontario Crop Insurance Commission.

The Ontario Crop Insurance Plan covers 70 percent of the average farm yields in the first year and increases to 80 percent during the following five years if the farmer makes no claims.

Total crop insurance writings for the Ontario Crop Insurance Commission were in excess of \$16 million in 1976.

Livestock and Bloodstock insurance offers coverage for death of livestock from fire, transportation collisions and upsets, theft and other accidental occurrences. Government plans also pay for animal losses resulting from epidemics. Ontario farm mutual companies are reported to be planning to introduce livestock mortality insurance covering the death of livestock from most diseases. Livestock insurance is also written on racehorses and other sporting animals and on breeding stock.

Various *floater policies* exist, designed to insure property, both personal and commercial, which is mobile in nature and which may be exposed to damage away from the business or dwelling premises. Examples are property in temporary storage, goods being held for sale under consignment, goods being installed and property undergoing processing outside the owner's premises. In addition, there are commercial movable property forms designed to cover the stocks or merchandise of certain types of business, such as jewellers and furriers, while the merchandise is on the insured's premises and also on the basis of incidental off-premises coverage.

Weather insurance protects against loss of income or extra expense due to rain, snow, sleet or hail, but not against damage to property.

Glass insurance covers losses caused by accidental breakage of glass, windows and doors on the basis of a quick replacement service. Ordinary property insurance contracts usually indemnify only, but do not provide repair or replacement service. The cost of ornamentation and lettering on the glass may also be insured.

Builders' Risk policies cover a building or other work under construction from all hazards such as fire, collapse, accidents to transports and so on.

Numerous other specialized property insurances are available, such as

computer insurance, valuable papers or articles insurance, accounts receivable policies, non-licensed equipment coverage, nuclear energy insurance and flood insurance (generally not offered by private insurers).

C. LIABILITY INSURANCE

The Liability category of insurance as defined in Chapter 3 to this Report includes surety and fidelity as well as liability forms of insurance. Personal liability insurance, for statistical reporting purposes, is largely included under the personal property category as part of the homeowner's package policy. Commercial liability insurance is therefore the main insurance form in this category and it is a rapidly growing market, spurred by so-called "socio-economic" inflation.

Described below are several of the more common forms of liability insurance. Many other forms are available: for example, pollution liability insurance or environmental impairment coverage is a new coverage of growing importance.

1. Comprehensive General Liability

A comprehensive general liability policy provides liability coverage for all basic liability hazards of a business except for contractual liability. All other possible exposures to a business are covered, including:

(a) Bodily injury and property damage liability:

- Ownership and Maintenance of Premises Coverage provides indemnification for injuries or damage resulting from a condition in or arising out of the insured premises; or
- Conduct of Business Operations Coverage provides indemnification for injuries or damage arising out of the activity of the owner or an employee either on or away from the insured premises.

(b) Products liability:

- Provides coverage for payment to third parties of losses involving injury or damage caused by products that either a manufacturer, wholesaler or retailer deals in. Two types of legal liability are possible arising out of:
 - (1) negligence;
 - (2) breach of warranty, wherein it is immaterial whether due care was exercised in the manufacture of the product.

(c) Employer's liability and voluntary compensation:

- Covers damages arising from injury to employees. The liability part is limited to employees or circumstances not covered by Workmen's Compensation legislation.

2. Professional Liability

Errors and Omissions insurance covers all payments which the insured becomes legally obligated to pay as damages arising out of the performance of professional services and caused by error, omission or a negligent act. It covers both professionals and business firms against their liability for damage to property or for acts which result in financial loss, not related to bodily injury.

Malpractice insurance provides coverage for specified professionals when bodily damage as opposed to property damage is involved. Coverage is similar to errors and omissions insurance and applies to doctors, dentists, hospitals and so on.

3. Other Business Liability Coverages

Contractual Liability covers losses arising from the legal liability for negligent behaviour as a result of voluntary assumption of that liability through a contractual agreement. Judgments then entered against the indemnitee (party performing the negligent act) are paid by the indemnitor (party assuming liability).

Directors' and Officers' Liability insurance provides coverage to individual directors and officers, held liable for ordinary negligence, or to the company if payment of a judgment is required.

Owners', Landlords' and Tenants' Liability is a form of Premises and Operations coverage that is often a part of general liability coverages. It is designed to insure owners and lessees of buildings, vacant land and mercantile establishments of all kinds. Coverage is divided into bodily injury and property damage.

4. Excess or Umbrella Liability

Excess Liability insurance provides catastrophe liability protection covering those judgments exceeding the limits of basic liability forms.

The insured must have basic liability insurance covering all normal and special exposures such as comprehensive general, automobile and professional liability policies. The umbrella policy is then written as excess coverage over the limits of the basic policies.

Coverages are generally far broader under umbrella policies than under basic liability policies, although several exclusions do exist. Advantages of the umbrella liability are the lack of territorial restrictions and coverage for virtually all contractual liability.

An umbrella policy is fundamentally a catastrophe contract, but equally important features are the 'drop down' feature and blanket nature of coverage that fill in the gaps left uncovered by primary coverages.

5. Surety Bonds

Suretyship is the practice of guaranteeing obligations through a three party contract. For example, an insurance company, the surety, agrees to be held responsible if a contractor, the principal, fails to complete a building contracted for by a business firm, the obligee. In the event of a loss under the bond, the surety (the insurance company) has a right to collect from the principal (the contractor) the amount that the surety has been obligated to pay to the obligee (the business firm).

Suretyship differs from real insurance in that no loss is expected when a surety bond is taken out, whereas an insurer generally expects losses to occur. Because of the “no loss” expectation, a bond is often regarded as a certificate of character, ability and financial worth.

The most common type of surety bond is the contract bond issued to contractors. A surety bond guarantees that a project will be completed. If it is determined the “bonded” firm cannot do the work, the surety company completes the project for the owner. The surety company has the right to collect back from the contractor all funds expended to complete the project. The resolution of any disputes over the funds is then decided through the courts.

6. Fidelity

Fidelity bonds are designed to protect the insured against loss resulting from dishonesty on the part of his employees. Fidelity covers loss or damage up to the face value of the bond, which is termed the penalty.

Protection is provided for dishonesty resulting while the bond is in effect, although losses discovered within a specified time after the bond has been cancelled will be covered provided the actual loss took place during the policy period.

Different forms of bonds are available, including:

- Name schedule bonds providing coverage on an individual basis.
- Position schedule bonds providing coverage of various positions within the company.
- Blanket bonds which cover all employees. These are of two types:
 - (a) Primary commercial blanket bonds provide coverage up to the face amount for any loss caused by any number of employees.
 - (b) Blanket position bonds provide coverage up to the face amount of the bond for each employee involved in a collusive loss.

Both types include an “excess indemnity rider” covering those positions that handle more money than others.

D. "OTHER LINES" INSURANCE

1. Marine

This category is most commonly termed wet marine or ocean marine and is purely a commercial class of business. There are four major classes of coverage corresponding to four types of losses which are transferred from the individual to professional marine insurers:

- (a) Hull insurance protects the owner of a vessel against loss to the ship itself.
- (b) Cargo insurance protects the owner of cargo from financial loss.
- (c) Freight insurance protects the owner of the vessel from the loss of the income earned from carrying the goods. The owner of the vessel is reimbursed for the loss of the income which would have been earned if the voyage had been completed.
- (d) Protection and indemnity provides protection for the owner of the ship for the consequences of his negligent acts, that is, those sums which the owner of the vessel became legally liable to pay to a third party would be paid by the insurer.

Risk coverage includes damages arising from perils "of the seas" excluding those arising from war, strikes, or riots.

A partial loss is referred to as "average" loss; and it may also be termed "particular" or "general" average. "Particular" refers to a partial loss of a particular interest borne entirely by the owner of the property involved in the loss. "General" refers to a partial loss that is borne by all parties to the venture—that is, where goods are intentionally jettisoned in order to save the vessel, this loss would be borne by all parties to the venture.

A warehouse-to-warehouse clause is often added whereby coverage is extended for the entire exposure from the time the goods leave the premises of the ship until they arrive at the premises of the consignee.

Most underwriters represent British or Foreign companies either by being a branch office, owned subsidiary or by contractual agreement. Competition exists not only among underwriters domiciled in Canada but with foreign markets as well.

The Canadian market is small relative to the world market primarily due to the small size of the Canadian ocean-going fleet.¹

Overseas underwriters insure the bulk of Canada's import and export shipments. They rely on adjusters or claims agents who may perform varying

1. For a description of the Canadian marine insurance market and industry, the reader is referred to the Canadian Transport Commission, Research Branch study, "The Marine Insurance Industry in Canada", April 20, 1978, Ottawa.

degrees of services for the insurer. At one extreme, the adjuster may have the authority to settle claims on the insurer's behalf. At the other extreme, the adjuster makes the loss survey and then sells it to the claimant who must mail it to the overseas insurer for ultimate acceptance or rejection. Cargo business provides the majority of marine claims work.

There is a federal government presence in marine underwriting, established to solve some of the problems experienced in placing certain classes of hull risks such as fishing vessels. The Fishing Vessel Insurance Plan, administered by a federal government agency (The Fisheries and Marine Service), provides low-cost insurance on a voluntary basis to all commercial fishermen in Canada in competition with private insurers. Fishing companies are included and this has raised allegations that public funds are being spent to subsidize, in some cases, fleets owned by multi-national corporations.

Overall, world-wide, competition is strong and there is generally little government control in marine insurance. Most of the insurance on import and export cargo is written outside Canada. Marine liability is primarily written overseas on the London market through Protection and Indemnity (P. & I.) clubs and includes pooling of the high exposure risks of oil spills and pollution.

The Ontario market for marine insurance amounted to \$18.0 million in direct premiums written in 1977 or 2.0% of the property and casualty insurance market total. These statistics exclude the business written at Lloyd's or with other unlicensed insurers. On an all Canada basis, it has been estimated that Lloyd's and other unlicensed writers account for about 30% of the Canadian market total.¹

2. Aircraft

Aviation insurance is a general classification, embracing all risks encountered in, or associated with, the ownership, maintenance, or use of aircraft. The most common aviation coverages are aircraft liability (passenger liability, bodily injury excluding passengers, and property damage liability) and hull insurance.

As in ocean marine, most underwriters represent British or Foreign companies. The top five writers in Ontario for example are foreign-owned.

Aircraft insurance is broadly divided into cargo, hull and liability insurance. Coverage may be placed outside Canada through brokers in the Province. Airplane cargo premiums are considered to be part of the property category such that the premiums written in this class relate mainly to hull and liability coverages. Coverage with Canadian insurers is also related primarily to private aircraft.

1. Ibid., page 32.

For the scheduled airlines, such as Air Canada, coverage is bought on international markets, mainly in London, New York and Chicago. The extremely high limits of coverage for hulls and for liability force risks to insure with pools outside Canada. Scheduled airlines also self-insure to a great extent for the myriad of minor claims they experience in the course of transporting thousands of people.

The Canadian market for aviation insurance appears to be larger in Western Canada than in Ontario because of the greater number of private airplanes. The 1977 premium volume written in Ontario (excluding Lloyd's) amounted to \$7.9 million, with the five largest writers accounting for a 64% market share. Lloyd's of London is however the leading underwriter of aircraft insurance in Canada, with close to a 50% market share or \$13.4 million in net premiums written reported on an all-Canada basis for 1977. Lloyd's premium volume written in Ontario is not available.

3. Boiler and Machinery

Boiler and machinery insurance provides coverage for loss arising out of the operation of pressure mechanical and electrical equipment; it may cover damage directly to the boiler and machinery itself and may include damage done to other property, as well as loss resulting from business interruption.

Inspection, on a regular basis, of the insured's equipment is required and the inspection fee is part of the insurance premium.

A policy covers four types of losses:

- (a) Loss to all property of the insured damaged directly by an accident to the insured object.
- (b) Expediting expenses such as temporary and/or permanent repairs.
- (c) Property damage liability.
- (d) Bodily injury liability.

Consequential or indirect loss coverages can be added by endorsement to the general policy and are of three types:

- (a) Use and occupancy coverage provides indemnity for loss due to a total or partial interruption of business.
- (b) Outtage coverage provides indemnity for each working hour during which the insured object is not available for service because of an accident, with no requirement that the business be interrupted.
- (c) Consequential damage coverage covers loss caused by spoilage of specified property resulting from an accident to an object such as a freezing plant or meat locker.

In buying boiler insurance, the insured also buys a regular inspection service and therefore relatively few companies offer this coverage because it requires a staff of qualified engineers. In 1977, 6 companies participated in about 80% of the business in Ontario, with the largest underwriting group, made up of the four Factory Mutual System companies, accounting for a 41% market share.

All Provinces except for Ontario insist on provincial government inspections of pressure equipment. The Ontario Ministry of Consumer and Commercial Relations also has a staff of inspectors but accepts the certificate of a reliable insurance company as sufficient evidence of inspection.

4. Mortgage Insurance

Mortgage insurance is required by most institutional lenders for all mortgages exceeding 75% of the property value. The cost of coverage is borne by the borrower in his mortgage payments but the lender acts as the intermediary in purchasing the mortgage insurance policy and transferring premiums to the insurer. Soaring home prices and speculative buying in 1973 and 1974 increased the demand for mortgage insurance.

Three companies write 100% of the mortgage insurance business in the Province of Ontario, which amounted to \$12.2 million in direct premium volume in 1977. The major writer is the Mortgage Insurance Company of Canada with a 67% market share in 1977.

5. Credit Insurance

Credit insurance protects against loss resulting from inability to collect accounts, due to insolvency of the debtor or debtors, unwillingness or inability to pay. Coverages include back coverage (defaults during the policy period), front coverage (sales during the policy period), extraordinary (specific customer) coverage, and general (all customer) coverage. Every credit insurance policy requires the insured to bear a specified percentage of each loss (coinsurance percentage), and it includes a "normal loss" deductible.

Credit insurance is a highly specialized field. For example, American Credit Indemnity is a U.S.-based company that writes about 75% of U.S. coverage and about 95% of coverage in Ontario. It is apparent from the size of the Ontario market (\$543,000 in direct premiums written in 1977) that credit insurance cannot support much competition.

Credit insurance is sold only to manufacturers and wholesalers and not to retail establishments. Most firms deal with the risk of losses from bad debts through their own loss prevention measures carried out by credit managers and their own risk assumption techniques. Manufacturers and wholesalers have recourse to other legal procedures for recovery, such as the Mechanics Lien Act, and may therefore decide to assume their own risk of loss.

Credit insurance is sensitive to economic activity and appears to be utilized more frequently in periods of high numbers of business failures. Nevertheless, there is generally low demand for credit insurance as companies which have large bad debt problems find it necessary to resolve these problems, not insure against them.

6. Title Insurance

Title insurance is designed to protect against losses resulting from a defective title to land and improvements (which may not be discovered in an examination of public records). The policy term is indefinite, covered by a single premium. In the event of a defective title, a dollar indemnification of losses is provided and not possession of the property.

Title insurance is mainly a risk avoidance service. About 80% of the premium pays for the insurer's search of title records to avoid any defects, and only about 5-10% is used to pay for losses. A policy is not issued if a title search reveals a defective title. Title insurance is primarily an outgrowth of U.S. experience with bad records that dates back to the Civil War. The market in Ontario is very small, with only \$58,000 in premiums written in 1977, with one writer, the Lawyers Title Insurance Corporation, writing virtually all business.

Title insurance today is a form of protection for a mortgage lender as well as the purchaser of property from such risks as forgery, lack of proper delivery, fraudulent representation of marital status, transactions that are voidable under bankruptcy or creditors' rights acts, undiscovered heirs, and so on. The cost of and time involved in defense is also assumed by the insurer and can be of significant benefit to the insured.

U.S. experience with title insurance indicates increasing loss levels resulting from higher loss payments, lawyers, fees and other direct expenses involved in the claims handling process.

The need for title insurance is, in part, reduced in Ontario by the Land Titles or Torrens system of registry which applied to some 29% of land registrations in the Province in 1977. Under this system, registration assures the purchaser of a clear title. The registration fee includes a contribution to a fund that is used to indemnify persons who can prove later that they have some right that existed prior to the registration. Losses paid are of a direct nature and, to date, no payments have been made out of the fund to cover consequential losses such as loss of business income. The Land Titles fund is sufficient to cover the "average" loss resulting from defective title. It is not designed to cover an extraordinary loss and has not to date been called upon for this purpose.

The remaining 71% of land registration in Ontario in 1977 fell under the Registry system. There is no contingency reserve fund provided under

this system, but individuals have the right to proceed against the Crown in court as the Registrar can be held liable for errors and omissions. Individuals also have the right to sue their lawyers for any error or omission, but the Registry system does not provide the added protection of an “unsatisfied judgment” fund.

APPENDIX G

(referred to in Chapter 3)

MARKET GROWTH IN THE GENERAL INSURANCE INDUSTRY

The dollar value of general insurance premiums written in Ontario on a direct basis has increased from approximately \$965 million to \$1,996 million over the 1973 to 1977 period. When inflation as measured by the Consumer Price Index is considered, the real growth in the industry in this Province was 44.8% over this period, or an average annual real growth rate for all categories of general insurance of approximately 9.7%. The remainder of this Appendix, however, refers to growth in current dollar terms, without adjustment for inflation unless otherwise indicated.

By comparison to the growth rate in Ontario, the all Canada growth rate was ahead of that in Ontario in the 1973-77 period. The average growth rate for all lines of general insurance during this period was 23.0% for all Canada and 19.9% for Ontario. In 1977, total direct premiums written in Ontario represented 34.6% of the total general insurance written in Canada compared to 38.2% in 1973. Table 1 below provides an Ontario and all Canada comparison of market size and growth in the general insurance industry.

TABLE 1
MARKET SIZE AND GROWTH IN THE
GENERAL INSURANCE INDUSTRY,
ONTARIO AND ALL CANADA, 1973-1977

	Direct Premiums Written \$000's		Percentage Growth in Current Dollars 1973-1977	
	1973	1977	Total	Average
Automobile				
Ontario	\$ 548,792	\$1,092,648	99.1%	18.9%
Canada	1,367,424	3,082,490	125.4	22.7
Property and Casualty				
Ontario	417,200	903,763	116.6	21.4
Canada	1,161,215	2,688,842	131.6	23.5
Total General Insurance				
Ontario	965,992	1,996,411	106.6	19.9
Canada	2,528,639	5,771,332	128.2	23.0
Ontario as a percentage of Canada	38.2%	34.6%		

The pattern of market growth in Ontario over the 1973 to 1977 period in the major lines of general insurance is illustrated in Table 2 below.

TABLE 2
YEAR-TO-YEAR PERCENTAGE CHANGE IN DIRECT PREMIUMS
WRITTEN IN ONTARIO IN THE GENERAL INSURANCE INDUSTRY,
1973-1977
(Current Dollars)

Major Product Lines	1974/3	1975/4	1976/5	1977/6	Average Annual Growth 1973-1977
Automobile	15.7%	28.3%	18.0%	13.5%	18.9%
Property	16.7	18.1	33.7	20.5	22.2
Liability	8.5	24.4	26.5	26.2	21.4
Other Lines	13.2	25.6	(4.3)	26.2	14.5
Total General Insurance	15.4%	24.8%	22.5%	17.1%	19.9%
Consumer Price Index	10.8%	10.8%	7.5%	8.0%	9.3%

Noteworthy are the premium volume increases in 1976 and 1977 in the property category and the increases in automobile and liability lines beginning in 1975. As a broad range of coverages are included in the major product line groupings, no single reason explains the variabilities in the pattern of growth. Table 3 below provides a more detailed look at individual lines within the property and casualty insurance sector.

TABLE 3
GROWTH IN DIRECT PREMIUMS WRITTEN IN ONTARIO
BY PROPERTY AND CASUALTY PRODUCT LINE, 1973-1977

Product Line	Percentage Growth in Current Dollars 1973-1977		Percentage Growth in Constant Dollars* 1973-1977	
	Total	Average Annual	Total	Average Annual
Property	123.4	22.4	56.7	11.9
Hail	7.7	1.9	(24.5)	(5.6)
Property	122.3	22.2	55.9	11.7
Liability	132.7	23.9	63.2	13.0
Surety	51.3	11.0	6.1	1.5
Fidelity	70.1	14.3	19.3	4.5
Liability	115.5	21.4	51.1	10.9
Marine	52.5	11.2	6.9	1.7
Boiler and Machinery	158.5	26.9	81.3	16.0
Mortgage	27.8	6.3	10.4	2.5
Aircraft	59.5	12.4	11.8	2.7
Credit	36.4	8.1	(4.3)	(1.1)
Title	(30.1)	(6.8)	(50.6)	(10.8)
Other Lines	71.8	14.5	20.5	4.8
Total Property and Casualty	116.6	21.4	51.9	11.0
Automobile	99.1	18.9	39.6	8.7
Total General Insurance	106.6	19.9	44.8	9.7

* Inflation adjustment based on the Consumer Price Index.

Over the 1973 and 1977 period, several lines contracted in real dollar volume written, namely hail, credit and title. Supporting data indicate a cur-

rent dollar volume decline in hail and title insurance premiums in 1974, 1975 and 1976, with a substantial gain evident in 1977 on the dollar volume of premiums written in both these lines. Particular attention should as well be paid to the property, liability and boiler and machinery lines because of their substantial rates of growth in the recent past. Supporting data show that boiler and machinery premiums in particular showed a major increase in volume in 1977.

APPENDIX H
(referred to in Chapters 4, 6 and 8)

**GUIDELINES REGARDING MASS OR GROUP
MERCHANDISING**

**A. DEPARTMENT OF INSURANCE GUIDELINES REGARDING
MASS MERCHANDISING OF AUTOMOBILE INSURANCE**

Over the years the Superintendent of Insurance has issued guidelines to licencees respecting the conduct of the business of insurance in Ontario. The purpose of these guidelines is to give some direction or instruction to insurers mainly with respect to new developments in the insurance industry. These guidelines do not alter in any way existing requirements of The Insurance Act or Regulations thereto.

Included is a guideline with respect to the marketing of automobile policies in synthetic fleets which was issued on August 1, 1969. The guideline arises out of the efforts of some automobile insurers to market automobile insurance on a mass merchandising basis. This guideline is still in effect.

The guideline is as follows:

**1. An Insurer Shall not Function for the Sole purpose
of Insuring a Single Association or Group**

A company must not be used for the sole purpose of providing insurance for a single group at a reduced premium thus defeating the intent of Section 363. No insurer shall refuse to accept a risk merely because the applicant is not a member of a particular group or association. In order to avoid the criticism that an insurer is functioning for the primary purpose of providing insurance for a single group, the insurer must satisfy the Superintendent that the company makes readily available and writes a reasonable percentage of automobile insurance business at the same rates outside the group.

2. Premiums Charged must be Adequate

Although the Superintendent does not approve automobile rates he does have a basic responsibility to report on the reasonableness of rate levels. In addition, he does have a particular concern respecting the adequacy of rates as it affects the solvency of insurers.

Any company which has a rate which varies substantially from the normal range of premium charged by the industry may be asked to justify such a rate and show that it does not represent a special underwriting prohibited by Section 363.

3. Advertising must not be Misleading

The nature and content of advertising circulated to members of associations or groups must not be misleading. Terminology should not be used which infers that special rates are being offered to members of a certain group solely because of their membership in that group.

Any rates quoted to group members must be available to persons outside the groups, otherwise it will be deemed to be a breach of the Statute. Insurers and brokers must assume responsibility for making certain that groups, through which they market insurance, do not give the impression that members are receiving a reduced premium because of their common association or membership. Inability to eliminate misleading advertising will be interpreted as a failure to meet the requirements of the Statute.

4. Filing Requirements

Insurers will be required to file with the Superintendent brief details of any arrangement entered into directly or indirectly with a group for the purpose of marketing or offering automobile insurance to its members or employees.

B. GUIDELINES REGARDING MASS OR GROUP MERCHANDISING SUBMITTED BY *THE INSURANCE BUREAU OF CANADA* TO THE ASSOCIATION OF SUPERINTENDENTS OF INSURANCE OF THE PROVINCES OF CANADA, FIFTY-SIXTH ANNUAL CONFERENCE, SEPTEMBER 1973

- (a) Groups which might be eligible for a mass or group agreement to include:
 - 1. employees of the same employer or a number of associated employers;
 - 2. members of a professional or occupational organization;
 - 3. members of a trade union;
 - 4. those participating in a common premium collection medium not specifically formed for the purpose of distributing general insurance.
- (b) Coverage shall be available to any member of the group, with rates of premium not higher than would have been charged the applicant if he were not a member of the group.
- (c) Insurance in force for any group member shall not be cancelled or lapsed except at the member's own request or for non-payment of premium, merely because the member ceased to be a member, until the expiry date of the coverage.
- (d) A risk insured under a mass or group merchandising plan shall not be

eligible for coverage under any inter-company pooling or risk-sharing agreement.

- (e) All advertising or merchandising material shall clearly state that any rate or premium savings offered below the insurer's standard premium for the equivalent risk classification, is enabled by savings and handling expenses and/or loss cost of the group.
- (f) Savings effected on the loss component of the premium dollar are to be accepted as a means of reducing the overall premium only on the basis of accumulated experience within the plan concerned.

APPENDIX I

(referred to in Chapter 7)

INVESTIGATIONS INTO THE FORM OF GOVERNMENT PRESENCE REQUIRED FOR ONTARIO

In the Committee's two Reports on automobile insurance, consideration has been given to the government's presence in insurance markets in Ontario in two major areas: the regulation of rates and the regulation of the solvency and liquidity of insurance companies. The Committee's views on these topics were tentative in the first two Reports and the Committee called for subsequent consideration of these matters when its review on the other-than-life components of the industry was completed.

This Appendix outlines, first as a background, the views and conclusions of the Committee in the first two Reports on the matter of a government presence in rate regulation and solvency regulation. It then provides a review of the scope of the Committee's further investigations into these areas and refers to the paper in Appendix J, titled "Monitoring Open Competition as a Method of Regulation in Insurance Markets". This Appendix concludes with a description of the major findings which arose in a meeting of a subcommittee of the Committee with representatives of the National Association of Insurance Commissioners in the United States.

A. BACKGROUND FROM THE FIRST TWO REPORTS ON AUTOMOBILE INSURANCE

1. A Government Presence in Rate Regulation

In its two Reports on automobile insurance, the Committee considered the question of governmental rate regulation. In its First Report the Committee considered the topic only briefly, stating "the Committee will consider this topic more fully in the course of its forthcoming sittings. It will identify various systems in use in other Canadian and United States jurisdictions such as rate setting, file and use systems, use and file system, etc. The Committee will study the merits of each system with a view to making final recommendations on this topic".¹

In its Second Report, the Committee went on to a more intensive consideration of the question of government rate regulation. The Committee's primary conclusion in the Second Report was as follows: "there is a fundamental need, particularly when a compulsory automobile insurance rule is established, for a governmental presence in the field of automobile insurance supervision and this applies specifically to rate regulation."² In addition, the Committee stated that "... more emphasis is required in Ontario

1. *First Report on Automobile Insurance*, page 243.

2. *Second Report on Automobile Insurance*, page 118

on rate regulation in order to achieve a better balance between financial stability and the other objectives of rate regulation''.¹

In order to assist the Committee in determining the appropriate *form* of the government presence in automobile insurance rate regulation, the Committee's consultants prepared a background study reviewing, in some detail, the history of rate regulation in the insurance industry, observations on the Ontario system, competition as a possible form of regulation in Ontario and other forms of government regulation as possible solutions for Ontario. The background study titled "A Government Presence in Rate Regulation" was appended as Background Study Three to the Committee's Second Report.

Based on the background study and discussions with the Superintendent and industry in Ontario, the Committee went on to express the view that: "... open competition rate regulation is the form of automobile insurance regulation which is best suited to the present market conditions in the Province of Ontario".² An open competition system of rate regulation is based on the theory that competition in itself will minimize premiums and ensure the existence of a reliable and efficient insurance system.

It was, however, apparent to the Committee that: "... an open competition system of rate regulation must not be considered out of the context of the overall topic of regulation and supervision of the insurance companies." The Committee therefore proposed to proceed with a more detailed investigation of the entire topic, which would include:

- "— The development of a suitable set of criteria for evaluating competition.
- The establishment of the methods and mechanisms, including public reporting requirements needed for regularly monitoring the existence and extent of competition in the Ontario insurance industry.
- The advisability of legislating these new requirements or providing for them in regulation."³

The Committee instructed its staff to work with the Superintendent on these matters in conjunction with a more detailed investigation into solvency and liquidity matters as described below.

2. Regulation of the Solvency and Liquidity of Insurance Companies

In the Committee's two Reports on automobile insurance, some consideration has been given to the solvency and liquidity rules as applied to the general insurance industry by the Ontario and Federal Superintendents of In-

1. Ibid.

2. *Second Report on Automobile Insurance*, page 119.

3. Ibid.

insurance. In its First Report, the Committee made a brief comparison of the tests as applied by the Ontario and Federal Superintendent and commented "the Committee is . . . concerned as a result of its review of solvency and liquidity tests to find that the authority of key tests is based primarily on the force of long-established custom and practice built up over many years in the Office of the Superintendent. These rules, which find their sanction in tradition and custom have come to be referred to as 'in-house' rules. There is generally little or no sanction by way of legislation or regulation to support them".¹ The Committee then went on to express the view that "the Committee wishes to add that its tentative view is that the present rules appear to be unnecessarily conservative".² In the conclusions to its First Report, the Committee set out as a matter for subsequent consideration "evaluating the present rules and recommending modifications thereto".³

The Committee's consultants prepared a report in some detail dealing with the solvency and liquidity rules and extracts from this report were included in the Committee's *Second Report on Automobile Insurance* as Appendix I. Based on this additional information and further discussions, the Committee commented in the body of its Report: "in considering new requirements for a greater government regulatory presence in automobile insurance, the Committee believes that attention should also be devoted to the present in-house tests and rules applied by the Superintendent's Office and their appropriateness in protecting the overall interest of the public".⁴

The Committee went on to express the view that it did not consider it appropriate to address final recommendations on these matters until its review of the other-than-life components of the industry is completed. The Committee therefore proposed:

- "Further consideration of the appropriateness of the solvency and liquidity rules as they pertain to the other-than-life insurance industry.
- Further consideration of the need to supplement or amend the present solvency and liquidity rules to make them more meaningful to present conditions.
- The advisability of legislating these new requirements or providing for them in regulation."⁵

be the subject of a more detailed investigation in the course of the consideration of the role and function of the Superintendent's Office. The Committee therefore instructed its staff to work closely with the Superintendent on these matters and those related to an open competition system of rate reg-

1. *First Report on Automobile Insurance*, page 208.

2. *Ibid.*, page 208.

3. *Ibid.*, page 243.

4. *Second Report on Automobile Insurance*, 117.

5. *Ibid.*, page 119.

ulation with the intent that "recommendations will be submitted in the context of the entire other-than-life insurance industry, rather than within the constraints of the report on automobile insurance."¹

B. SCOPE OF INVESTIGATIONS FOR THE THIRD REPORT

More detailed investigations into the government's presence in insurance markets in the areas of rate regulation and solvency regulation involved the scope of work outlined below.

1. Study Into Systems of Monitoring Competition

The Committee instructed its consultants to work closely with representatives of the Office of the Superintendent of Insurance to:

- Define the criteria that would indicate the existence of open competition in the setting of insurance rates;
- Suggest the means by which the industry could be monitored to ensure that the criteria of open competition are being satisfied.

A draft background paper on the subject of monitoring open competition was prepared and is included as Appendix J to this Third Report. This background paper is the product of a field trip undertaken by a representative of the Committee's consultants and Mr. Lear P. Wood, Director of Insurance Services for Ontario, to the office of the National Association of Insurance Commissioners (N.A.I.C.) in Milwaukee, Wisconsin. Meetings were also held with the Commissioner of Wisconsin and the executive assistant to the Commissioner of Illinois.

2. Study into Solvency Regulation

Further research into the matter of solvency and liquidity, in the context of open competition, was performed by the Committee's consultants. The Committee's preliminary observations from this study included:

- The Committee has been satisfied that the present solvency rules, some of which are legislated and some of which are "in-house" guidelines, provide adequate protection to consumers against losses from insurance company insolvency. This being so, it may be that, in some instances, the present rules are unnecessarily conservative since they are designed to be applicable to all insurance companies whereas solvency is entirely dependent upon individual company circumstances.
- It may also be said that, in some instances, these rules add unnecessary costs to the insurance products which Ontario consumers must

1. Ibid., page 119.

bear because of the cushions which the solvency tests build into the system.

- In addition, in theory and in practice these rules automatically place a restriction on the industry's capacity to write new risks and in particular may unduly limit the amount of business the more efficient companies may write.
- While solvency is one of the primary objectives of insurance regulation, it may, in some instances, be contradictory to another primary objective, namely the provision of insurance products to consumers at the lowest possible cost.
- Open competition rate regulation is based upon the premise that the mechanisms of a competitive market place are likely to provide the best safeguards for delivery of the insurance product at a price which bears reasonable proportionality to cost and normal rates of return.
- One of the indicators of effective competition is the ease with which companies enter and exit from the market place. Because of the present solvency rules, it may be argued that involuntary exit as a result of competition is almost precluded. Viewed another way, it may be said that solvency regulation forces insurance premiums to a level which are at least sufficient to ensure that the solvency tests are met; such regulation may therefore hinder competition at lower premium levels and might be termed anti-competitive.

3. Meeting With N.A.I.C. Representatives

On January 4, 1979, a subcommittee of the Committee, composed of Messrs. Breithaupt, Reid, Yakabuski and Laughren, the Superintendent of Insurance, Mr. Murray Thompson, and representatives of the Committee's consultants travelled to Milwaukee, Wisconsin to the offices of the National Association of Insurance Commissioners to discuss further the matters of open competition rate regulation and solvency and liquidity. A listing of those persons who met with the Committee members from the N.A.I.C. is as follows:

- Mr. H. P. Hudson, Commissioner of Insurance, State of Indiana, President of the N.A.I.C.;
- Mr. Wesley J. Kinder, Insurance Commissioner, State of California, Chairman of the Executive Committee;
- Mr. Harold R. Wilde, Jr., Commissioner of Insurance, State of Wisconsin, Chairman of the Competition Subcommittee;
- Mr. Richard L. Mathias, Director of Insurance, State of Illinois, Chair-

man of the Financial Condition, Examination and Reporting Committee;

Mr. Phillip O'Connor, Assistant to the Director of Insurance, State of Illinois;

Mr. Robert E. Dineen, Consultant, N.A.I.C. Central Office;

Mr. Robert A. Bailey, Actuary-Director of the N.A.I.C. Data Base, N.A.I.C. Central Office; and

Mr. Jon S. Hanson, Executive Secretary and Director of Research, N.A.I.C. Central Office.

Considerable discussion of the above topics ensued and the essence of that discussion provides the subject matter of the balance of this Appendix.

C. MAJOR FINDINGS ASSOCIATED WITH THE MEETING WITH N.A.I.C.

The subcommittee was received enthusiastically by the representatives of the National Association of Insurance Commissioners who were equally interested in watching the developments in Ontario related to insurance industry regulation. The discussion which took place was totally candid and most germane to the investigation of a number of issues which currently confront this Committee. Major findings of the discussions at the N.A.I.C. are detailed below.

1. Open Competition Rate Regulation

Stage of Development

The concept of "open competition rate regulation" is in the process of evolution in U.S. jurisdictions. While there has been considerable study and writing on the subject, at the present time it does not appear that any state regulator monitors the efficacy of competition in the full context promulgated in the 1974 N.A.I.C. study entitled, *Monitoring Competition: A Means of Regulating the Property and Liability Business*.¹

Not even the state of California, who pioneered this concept in 1947 in the face of considerable criticism, "monitors" in the fashion contemplated by that study. California, which is likely more sophisticated than any other state in terms of an "open competition" approach to regulation, acknowledges that the concept of monitoring competition is still in an evolutionary stage. As a further example of U.S. progress toward monitoring competition, the New York State Commissioner issues reports on a periodic basis that review the competitive situation in that state according to a number of criteria, but do not take into account all the various tests proposed by the N.A.I.C.

1. For background and a detailed discussion of the move to "open competition" regulation in the United States, see *The Second Report on Automobile Insurance*, Background Study Three: "A Government Presence in Rate Regulation".

The mandate of the N.A.I.C. does not allow it to regulate, as it is an association which facilitates research, statistics collection, liaison with industry and government, and so on for its membership of state regulators. As such, it acts as an agency for the collection of data which it then disseminates to the individual state insurance departments. As described more fully in Appendix J, the N.A.I.C. has developed, out of its studies, a system for the collection of data which may be utilized to monitor market behaviour. Because the concept of monitoring is new, the data base is also new and it is not held out as being totally comprehensive or conclusive. Continuing study and development is occurring with respect to certain of the data collected.

The technical aspects of the concept of monitoring competition and the data base associated with the monitoring system have been criticized by economists representing the federal perspective. The major thrust of the defence initiated by the N.A.I.C. has been one of promotion of the concept in the absence of a viable alternative. To date it is understood that no appropriate alternative has been put forth.

Depending upon the form of state regulation which exists in the various states, state regulators appear to be using the N.A.I.C. data in a variety of ways ranging from minimum utilization in rigid prior approval states to attempts to monitor market behaviour in those states with competitive rating laws. The consensus expressed to the Committee, however, was that no state has yet progressed to the level of sophistication envisaged in the N.A.I.C. study because of the premature stage of development of the concept and the data base, and the admission that neither the N.A.I.C. nor state regulators had addressed the longer term practical applications of the system. When the N.A.I.C. representatives were questioned further on the subject, it was evident that the monitoring opportunities provided by the data could mean different things to different users and still provide a useful regulatory tool for all.

Because the N.A.I.C. system merely collects and disseminates market behaviour information, an informed judgmental assessment of the effectiveness of competition on the part of state insurance departments was described to be an integral part of this regulatory process. While the N.A.I.C. representatives did not foresee, for the time being, that state Commissioners would issue an overall assessment of competition, it was reasonably clear that they felt that the Commissioners would eventually be in a position to do so and, certainly, that they would be in a position to act on, and to publicize through periodic reports, the absence of competition in specific segments of the market place, such as geographic or product line segments.

Present Activities

For those jurisdictions who utilize competitive rating laws, open competition rate regulation appears to be a target for which they are striving but

which they have not yet achieved, given the stage of development of the concept of monitoring the efficacy of competition. In these jurisdictions, and in particular in Wisconsin, Illinois, and Indiana whose Commissioners addressed members of the Committee, it is apparent that regulators, while being committed proponents of the monitoring concept, are presently devoting considerable time and effort to those activities which will *foster* competition in the insurance market place. They attempt, through the monitoring system and other methods, to identify deficiencies in the market place and stimulate or promote competition in these areas. In addition, they often initiate or are very supportive of any activities which will contribute to the enhancement of consumer awareness of the market and knowledge of the insurance products.

Specific examples which were cited to the Committee are as follows:

1. The Wisconsin Commissioner is most supportive of a recently implemented life insurance "hot-line" which is operated by a public legal aid office. Funding comes from a variety of state and federal sources. Rates on current sample coverages are quoted to callers by this office. The information on rates is developed by the Office of the Commissioner.
2. The Illinois Commissioner has a sophisticated computer-based tracking system for consumer complaints which he appears to utilize to advantage in a variety of ways. In one instance, he described the detection of an insurer in financial difficulty merely by staff follow-up of an identified lag in claims settlements by this insurer in certain zip-code geographic territories. When violators are identified by the system, the Commissioner, as he deems advisable, calls a press conference to publicize this fact and in many instances he receives "front page" coverage.
3. While some difficulties were cited with the currency and comparability of rates and coverage, all Commissioners were highly supportive of the practice of publishing the results of their offices' periodic rate surveys of the industry in specific areas.
4. The Indiana Commissioner, who has had considerable industry experience, stated he would promote any project in his state which involves the dissemination of rate comparisons to the public. Such projects generate a flurry of activity in the agency system and have a profound impact, in his opinion, on insurers who are forced by their own agency sales forces to become more price competitive.
5. Certain jurisdictions, Wisconsin being named, permit the regulator to initiate a non-profit pooling mechanism to service certain product lines in instances where the regulator determines that there is an absence of competition because of the very small number of active writers. Once a reasonable number of writers return to the market, the mechanism is discontinued.

In sum, the theory and practice of open competition rate regulation differ somewhat in the numerous U.S. jurisdictions who support the concept at the present time; as indeed they might differ in terms of appropriateness and application in the Province of Ontario. Nevertheless, it would appear that much can be learned and applied in Ontario from the efforts and attitudes of U.S. regulators in the fostering and promotion of competition in the insurance market place.

2. Surveillance of Insurance Company Solvency

Discussion with N.A.I.C. representatives on the topic of insurance company solvency centered on three matters, namely:

- The reasons for the differing U.S. and Canadian experience as far as the number of insolvencies are concerned;
- The identification of differences in regulatory requirements, if any, and the application of these requirements in practice by the regulators themselves;
- The N.A.I.C. viewpoint with respect to the results of Canadian regulatory practices in connection with insurance company solvency.

While the topic of solvency regulation by its nature renders definitive conclusions difficult and likely requires considerable study, the Committee was able to glean from the N.A.I.C. visit further insights into this matter.

N.A.I.C. representatives felt that two major factors contributed to the larger number of insurance company insolvencies in the United States. Sheer size of numbers of companies competing in the market place was one factor. Illinois and California, for example, have in the range of 1,400 to 1,600 companies operating in their states, including life and accident and sickness companies compared with approximately 360 in Ontario. All the U.S. regulators present in Milwaukee cited fraud as likely the other major, differentiating factor contributing to insolvencies, presumably on the premise that this problem was much more prevalent in the United States than in Canada.

The Committee attempted to identify failures in the solvency regulatory system as another differentiating consideration, because of the apparently looser application of solvency rules in some U.S. jurisdictions. The N.A.I.C. representatives acknowledged certain examples of these occurrences but generally felt them to be few and far between. G.E.I.C.O. was cited as the major occurrence of regulatory failure—its premium to equity ratio apparently peaked at 13:1 before its problems were uncovered and it was restored to financial health. Solvency is much more closely monitored since the G.E.I.C.O. experience.

Because primary regulatory responsibility rests with the insurance de-

partment of the state of insurer domicile, the Committee also explored the possibility of insurer operations falling between two or more regulators, as in the case of G.E.I.C.O. which operates in 52 jurisdictions, with neither effectively overseeing solvency matters. Again, some minor examples were discussed but the consensus indicated that now, perhaps as a result of the problems with G.E.I.C.O., these matters are as effectively controlled from a regulatory viewpoint as is reasonably and cost-effectively possible. Certainly, the implementation in many states of the N.A.I.C. "Early Warning System"¹ and the activities of the state Commissioners in monitoring such factors as consumer complaints would indicate that this is the case.

The Committee then attempted to distinguish the interpretation and application of solvency rules by U.S. regulators from that of their Canadian counterparts. Recognizing that the present rules or variations thereof were developed for the most part in the United States, the Committee wished to identify the differences in their application by regulators in the two jurisdictions. Upon further questioning it became abundantly clear that U.S. regulators regard the "premium to equity" rule as a benchmark indicator only which may properly vary between individual insurers according to their respective circumstances, book of business and other individual factors. On average, U.S. property and casualty companies are presently operating at a ratio of 2.9:1, with some as high as 4:1 and even 5:1. It was felt that these ratios are entirely proper and appropriate in the particular circumstances of the companies involved.

Accordingly, as far as the Committee could determine, the interpretation of the rules is similar in both jurisdictions: both regard the rules as measurements of financial stability. However, the application of these rules is significantly different. Canadian practice relies on the much more rigid application of, for example, the 2:1 premium to equity rule, to protect against insolvencies, while the trend in the American practice is to rely on a series of more flexible "early warning" tests to provide this protection supplemented in some jurisdictions with guarantee funds.

1. See *Second Report on Automobile Insurance*, Background Study Three.

APPENDIX J

(referred to in Chapter 7 and in Appendix I)

MONITORING COMPETITION AS A FORM OF RATE REGULATION IN INSURANCE MARKETS*

SUMMARY

The arguments favouring a government presence in insurance markets are well established. They are based on the requirement for solvency and the perceived need to make reasonably priced insurance widely available.

Interference in the market place arbitrarily to set rates limits competition, leads to economic inefficiency, and increases the economic costs of providing insurance.

Open competition rate regulation has been recommended as a means of allowing the government presence to be realized while giving market forces reasonable latitude to determine rates in a competitive way. The protection of the public interest suggests that open competition rate regulation will have to be monitored.

The monitoring mechanism is based on the concept of workable competition which suggests that measures of market performance and market structure are possible which can be used to assess the presence of competition.

Open competition rate regulation has evolved in the United States and several states have experimented with open competition rating laws. Legislation has been proposed in Illinois that provides explicitly for monitoring of open competition. This legislation proposes an innovative approach to defining market segments.

The National Association of Insurance Commissioners has conducted a study to calculate some of the performance and structure measures that have been suggested as part of a monitoring mechanism. The results of this study suggest that developmental work should continue and reinforce the importance of judgmental assessment in the monitoring process.

The specific indicators suggested by the N.A.I.C. are:

— Performance Indicators:

1. Property and liability insurance profitability, all lines country-wide
2. Comparison of inter-industry rates of return
3. Operating profit by line by state
4. Variation in premium rates

*Prepared for the Select Committee on Company Law by Woods, Gordon & Co., consultants to the Committee, in cooperation with the Office of the Superintendent of Insurance.

5. Independence in pricing
6. Frequency of price changes

— Structural Indicators:

1. Concentration ratios by line by state
2. Market share ranking by line by state
3. Entries and Exits.

The rudiments of monitoring are already in place in Ontario. The Department of Insurance monitors prices in the automobile insurance market and looks at concentration in a rough way.

The application of the concepts of workable competition would provide a framework in which monitoring in Ontario could be further developed.

A. THE PURPOSE OF MONITORING MARKET BEHAVIOUR

This paper examines the ways in which the monitoring of market behaviour in the sale of insurance can be carried out in order to assess the efficacy of competition as a regulator in the setting of insurance premium rates. Consideration is given here to the theory and techniques of open competition rate regulation as a result of the conclusion of the Select Committee in its Second Report that "open competition rate regulation is the form of automobile insurance regulation which is best suited to the present market conditions in the Province of Ontario".¹ Should open competition rate regulation be introduced into Ontario, the government's presence in the insurance markets of this Province will be felt primarily through the information demands of an eventual system of monitoring market behaviour.

This paper suggests a suitable set of criteria that can be used in a system of monitoring the existence and extent of competition in the Ontario insurance industry. As well, it examines monitoring activities that are currently carried out in Ontario and in various states of the United States. It concludes by discussing various aspects of data collection that will need to be addressed in a more complete review of data to be carried out with the cooperation of the Department of Insurance.

1. The Need for a Government Presence

The need for a government presence in the marketing of automobile insurance has already been well established in the Select Committee's Second Report. That report recognizes that the social usefulness of insurance is enhanced if risk coverage is widely available, the price of this coverage is reasonably related to cost, and the insurance mechanism itself is reliable in the sense that loss claims in the future will be paid by solvent insurers. The fact that these goals of availability, cost efficiency and reliability are not all con-

1. The Select Committee on Company Law, *The Insurance Industry—Second Report on Automobile Insurance*, Province of Ontario Legislative Assembly, 1978, page 118.

sistent one with the other has contributed to the argument for a government presence.

The nature of the market demand for insurance coverage also has implications that support the need for a government presence. In a society where risk aversion is a dominant characteristic of personal and business behaviour, insurance is seen as a necessity. As a result, the quantity of coverage demanded tends to vary relatively little with price. In economic terms the demand for insurance appears to be highly inelastic. This statement does not preclude the possibility that individuals may react quite sharply to price increases or price decreases as they purchase insurance coverage. It simply says that across the broad average of society the demand for insurance coverage by consumers is relatively insensitive, or inelastic, with respect to price.

This characteristic of the demand for insurance increases the possibility of collusion amongst the suppliers of insurance in their pricing behaviour. It is well known in theory and in practice that the advantages of collusion are primarily the ability to extract monopoly profits. In general, collusive activity would preclude the realization of at least two goals in the provision of insurance, by encouraging the sale of insurance at prices that are unreasonable in the sense that they are influenced by factors other than costs and by reducing the supply of insurance to extract higher prices and hence limiting the availability of coverage.

Historically the establishment of rate regulatory procedures has been directed at curbing monopoly profits and setting insurance prices at publicly perceived reasonable levels while providing for solvency. In spite of these objectives, it remains true that whether prices are set through collusion or by regulation, there is a strong possibility that the public interest will not be served. In a regulated system where market forces are minimized, it is very difficult to determine what will constitute a competitive return for firms engaged in the sale of insurance. In addition, in most jurisdictions where the goal of a reliable insurance mechanism has taken precedence and the focus of regulation has been the maintenance of solvency, it can be argued that regulators will encourage rates that result in returns above those which would otherwise be realized under a competitive system. In this environment, insurance firms will tend to compete on the basis of factors other than price as they attempt to increase their share of the market and, thereby, increase their volume of profit. Analytically, the result of this non-price competitive behaviour is an increase in the costs of providing insurance coverage and an impairment of economic efficiency in the market place.

2. Open Competition Rate Regulation

Open competition rate regulation has been recommended as a means of obtaining the goals of availability, economic efficiency and reliability in the

provision of insurance while avoiding the difficulties discussed above. The proponents of this approach suggest that its chief strengths lie in the possibility of independent pricing, pricing flexibility and operating flexibility. The government role could be limited to monitoring market behaviour to assess the degree to which competitive forces are present. In practice the government could actively promote competitive behaviour in the market place in addition to monitoring market behaviour.

Open competition rate regulation has decidedly practical advantages in that it allows for a government presence in the regulation of insurance premiums without the necessity of building a large regulatory bureaucracy. In principle, the monitoring of open competition rate regulation should be a relatively efficient enterprise. The data required to calculate the monitoring measures themselves can be collected in the normal course of data collection required to monitor solvency. Experience in the United States suggests that, in practice, some time will be required before an adequate monitoring data base can be accumulated. The refinement of existing data series and the development of a few new series will be an initial requirement in the establishment of any monitoring system.

3. The Evolution of Monitoring

In the United States, interest in regulating rates through reliance on the operation of competitive market forces has spread in the past two decades. By the late 1950s and early 1960s the movement towards open competition rate regulation found growing support because of the widespread dissatisfaction with the operation of the property and liability insurance business. At that time a noticeable reduction in the availability of insurance, coupled with rapidly increasing insurance premiums, generated significant public criticism and dissatisfaction with the prior approval rating laws by which insurance rates were then generally regulated.

This dissatisfaction occurred in concert with two other important factors which contributed to pressures for open competition in the establishment of insurance prices. The first factor was a generally favourable reassessment, in the United States in particular, of the efficacy of the market economy in providing goods and services. By the early 1970s the temper of the times was one of growing conservatism and throughout the business community greater emphasis was being placed on allowing the market mechanism to do the work of allocating goods and services. A second factor at work in the United States concerns the continual struggle between federal and state governments in the regulation and determination of economic activity.

As the 1970s progressed it became clear that there was strong pressure in some circles for a federal government presence in the regulation of insurance market activity. In response to this pressure the various state commis-

sioners through the National Association of Insurance Commissioners (N.A.I.C.) pressed for the elaboration of an open competition rate regulation system by which the benefits of market activity could be realized in insurance markets under the purview of state agencies. A step in this direction was the preparation of an extensive report on *Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business* which was published in 1974 by the N.A.I.C. central office. This report represents the first comprehensive treatment of the problem of open competition rate regulation from both the theoretical and practical points of view.

At the state level, some progress towards open competition rate regulation had already been realized by the early 1970s. California had already established a specific open competition rate regulation law in 1947 and Florida enacted similar legislation in 1967. In the state of Wisconsin, the insurance statutes were revised to be consistent with an open competition rate regulation approach in the setting of insurance premiums. Illinois and New York adopted specific although temporary open competition rating laws in 1969 and 1970 respectively. Other states were operating under what were essentially open competition rating regimes and the 1974 N.A.I.C. study listed seventeen states as having open competition. New York, Illinois and Florida have since allowed their open competition legislation to lapse. In Illinois, the only control over market behaviour is that provided for by federal anti-trust legislation.

In addition to these forces which operated to encourage the consideration of open competition rate regulation, the last few years have witnessed a growing awareness of the growth of government participation in the North American economy. The demands for cutbacks in the growth of government expenditures generally and reductions in specific levels of expenditure have been focussed on the operation of governments in a variety of regulatory fields. As a natural consequence, the size of regulatory groups is being reduced in many instances. For example, changes in the Louisiana rating laws, which relieve the rating commission of the necessity of providing various kinds of data, resulted in a reduction of the rating commission staff by 60 employees and an annual saving to the state of close to half a million dollars.

B. THE MEANING OF COMPETITION IN MARKET BEHAVIOUR

While the establishment of insurance rates through competition in the market place is desirable in principle, it will be necessary to have some means of determining the extent to which competitive forces are at work. This determination is made difficult by a variety of problems. These include a lack of understanding about the nature of competition and practical problems of definition and measurement that are only now being addressed. This

section will examine the source of some of these problems and discuss their implications.

1. Economic Theory and Competition

In economic theory the meaning of competition is very precise. The theory of price determination is based on a hypothetical model of markets in which price competition is the only means of competition. In this so-called perfectly competitive market, stringent assumptions bring about this result. Some of the more important of these assumptions are:

1. There is a well defined homogenous product.
2. There are enough participants in the market so that no one individual or firm can exploit his position.
3. There are no barriers to prevent producers from entering or leaving the market.
4. There is full information available to both producers and consumers about possible alternatives.
5. There are, at some point in the production of the goods, increasing costs.
6. There is independent consumption.
7. There are no externalities in the production of the goods.
8. Rationality prevails in the market place.

As a result of these assumptions, it can be demonstrated that all participants in this hypothetical market are price takers. In other words, no one individual or firm can affect the equilibrium market price which is established as a result of the actions of all market participants taken together. For example, if a particular firm tries to set a price higher than the market price in a perfectly competitive situation, it will find itself losing customers and operating in an inefficient manner. Theoretically, the first evidence of this will be that the entrepreneur finds that his returns from engaging in the business are not sufficient to cover his opportunity costs of being involved in the market. Eventually, the loss of customers will result in actual economic losses accruing to the firm and the firm will have to reduce prices or go out of business. If, on the other hand, a firm lowers prices it will not cover costs and will find its losses mounting. In perfect competition it is to the firm's advantage to "take" the equilibrium price in the market as its own, and it is in this sense that firms are known as price takers.

Market activity under the conditions of perfect competition will bring about automatically an equilibrium situation in which theoretically the allocation of resources in society is optimal. In general terms, this means that there can be no reallocation of resources that can make any individual better

off without reducing the welfare of some other individual. From this result it is easy to see why the theoretical model of perfect competition is such a powerful argument for allowing competitive forces to determine market prices.

2. The Concept of Workable Competition

In practice a dilemma arises because, once one of the assumed conditions of perfect competition is relaxed, it becomes possible for firms to compete on a basis other than price. With the admission of non-price competition into the hypothetical market place, it can no longer be said with certainty that the allocation of resources is optimal in the equilibrium situation.

Of course in the real world it is likely that many of the conditions required for perfect competition to exist are being violated. The extreme reaction to this fact has been the suggestion that the market system should be abandoned altogether and the pricing of goods and services and the allocation of resources should be a matter of public planning. Aside from the ethical and political considerations of such a suggestion, the analysis of monopoly suggests that the economic costs associated with abandoning the competitive market system would be very high.

As a result, economists have struggled with the idea of translating the notions of perfect competition into a more operational framework. The result of this effort has been the elaboration of the concept of workable competition, a results-oriented practical application of the market analysis contained in the theory of price determination in a perfectly competitive market. Loosely defined, workable competition describes any market system whereby competitive forces are allowed to work and competitive results are derived. Workable competition is concerned with the practical ways in which markets perform rather than the theoretical analysis of how markets work.

3. Workable Competition and Monitoring

Workable competition suggests that the performance of a market can be monitored, and that the results of market activity can give some indication of the degree to which competition guides that activity. The results of market activity are reflected in variables such as prices, profit levels, and the degree of concentration in the market. Generally, these variables are grouped in three different categories of market tests that can be used to assess whether or not a market setting is workably competitive. These are tests of:

- performance,
- structure, and
- conduct.

The measures of market structure and market performance are largely economic and statistical in nature, while the assessment of market conduct is more legal in nature. However, it needs to be asserted that the evaluation of whether or not a market is workably competitive will require the application of a large amount of judgmental assessment to whatever statistical measures of performance, structure and conduct are devised.

4. Performance Tests

Tests of performance are concerned with:

- pricing behaviour,
- profitability,
- availability of insurance, and
- solvency.

The measures of performance in an industry are examined to ascertain whether or not the results being achieved in a particular market are consistent with those that one would expect in a competitive market.

The monitoring of *pricing behaviour* is intended to assess in the overall market the degree to which firms are acting as price takers. In practical terms this means evaluating the extent to which observed price increases are justifiably related to changes in costs. The monitoring of *profitability* focuses on overall industry profits in relation to profits in other industries and the concept of normal or reasonable profitability. Rates of return in the insurance industry are compared with those of other industries in order to assess the relative performance of the industry. Tests of *market availability* are designed to determine whether or not insurance coverage is readily available throughout the market.

The important aspect of profitability in assessing whether or not a market is workably competitive is the degree to which industry profit levels exceed those required to attract and retain capital. In the theory of competitive markets, 'normal' profits are usually defined as those profits that will attract capital to the activity in question and prevent it from being moved to other productive activities. Profits over and above these so-called normal returns are excess, in the sense that they are not needed to retain capital in its present use. Theoretically these excess profits will attract new competitors to the market or encourage existing firms to compete more vigorously. In the absence of competition these excess profits would persist over time.

The source of these excess profits could be an improvement in cost structure brought about by increased efficiency as a result of innovation or higher prices as a result of increased demand. In the insurance industry an example of the first source of profit growth would be reduced costs through the adoption of electronic data processing or improved loss experience, while an example of the second would be the imposition of a mandatory re-

quirement for coverage of a particular risk. If other indicators such as loss ratios or legislative action suggest changes in the cost of price structure, then profit measures will need to be monitored to determine if excess profits prevail.

The three performance tests discussed above are market-wide tests. It is important to remember that competition as it is being evaluated in this context is a market phenomenon. As such, it summarizes the behaviour of the entire spectrum of firms operating in a particular jurisdiction and this behaviour must be examined jointly.

The concern for reliability of the insurance mechanism creates a requirement for a performance test that is specific to the insurance market, the insurance-specific test being a measure of *solvency*. Normally in attempting to determine whether or not a particular market is workably competitive, the question of an individual company's solvency would not arise. In theory the operation of economic markets dictates that at times the lack of efficiency or the failure of entrepreneurial ability that may be characteristic of an individual firm will lead to insolvencies and cause that particular firm to exit from the industry. However, because of the nature of the insurance product, individual firm solvency has always been an important performance indicator and the traditional focus of the government presence in insurance markets.

The monitoring of open competition rate regulation does not discount the importance of solvency, it merely suggests that other performance tests of competitive behaviour are necessary in order to determine the extent to which insurance markets are workably competitive.

5. Structural Tests

Tests of structure examine measures that include the number and size of the firms operating in the market, the concentration of market power and the possibility of entry to and exit from the market. The greater the extent of the concentration of market power in the hands of a few firms, the less competitive the market will be. The examination of these measures is intended to reveal whether or not the structure of the market will allow competitive forces to operate.

6. Conduct Tests

These tests are intended to reveal whether or not observed market conduct is characteristic of competition. The examination of the conduct of economic activity has traditionally been the province of those authorities who enforce anti-trust legislation and the focus has been on the legal aspects of doing business. There are no specific measures of market conduct that can be calculated or assessed in a system designed to monitor markets. The actual instances of anti-competitive behaviour that are discovered and investi-

gated provide the only yardstick by which market conduct may be measured.

C. MONITORING MARKET BEHAVIOUR

The movement from a system of prior approval rate setting in the United States to one characterized by open competition rate regulation has been slow. Progress has been slow of necessity because of the need to collect data and the requirement for ongoing evaluation of the monitoring measures themselves. While the support for open competition rate regulation is obvious in jurisdictions such as Wisconsin, California, Illinois and New York, these jurisdictions do not yet actively monitor competition in a systematic way. However, legislation dealing with competitive rate regulation was recently introduced in Illinois¹ and provides a clear indication of the direction of future development. In the meantime, the National Association of Insurance Commissioners has followed up its 1974 study by developing calculations of the measures of performance and structure suggested therein.

1. The Proposed Illinois Legislation

The legislation proposed for Illinois is interesting in that it provides for the definition of a market segment in the sale of insurance and provides for active monitoring of market activity in that segment. In the proposed legislation a market segment will be determined by some combination of the line of insurance, the class of risks and the relevant market area within the state. The definition of market segment is an attempt to rectify difficulties which are encountered in defining the insurance product market for the purposes of monitoring.

The general thrust of the Illinois legislation is that insurance rates in particular market segments shall not be excessive, inadequate or unfairly discriminatory. In the language of the proposed legislation "no rate shall be held to be excessive unless (1) such rate is unreasonably high for the insurance provided, and (2) a reasonable degree of price competition does not exist with respect to the market segment to which such a rate is applicable". The tests of competitiveness suggested by the legislation are essentially the performance and structural tests referred to above. These tests will include an examination of the number of companies actively engaged in the market segment, a determination of the existence of rate differentials in that segment, an assessment of whether profitability for companies generally in the market segment is unreasonably high in relation to riskiness, a measure of the degree of domination of the market segment by one or more companies, and the practical opportunities available to consumers in the market segment to compare and obtain insurance from competing companies.

In evaluating the profitability of insurance companies, the proposed

1. State of Illinois, 80th General Assembly, House Bill 3223, Introduced April 14, 1978.

legislation provides that a rate shall not be held to be excessive solely because it permits a profit for a company, provided that such profit is not unreasonable in relation to the degree of risk in any market segment. The legislation further provides that all income of the company, including income on investments of any kind wherever located, shall be considered in the determination of profit.

The approach to monitoring included in the proposed Illinois legislation is consistent with the general developments in the area of open competition rate regulation that have occurred in the United States in the recent past. The proposed Illinois legislation departs from recent developments in that the monitoring system will look at market segments rather than lines. The writers of the Illinois legislation felt that the monitoring of competition by lines may not indicate a lack of competition when in fact it is absent. While the concept of market segment is not clearly defined in the legislation, it is hoped that the concept will allow the monitoring agency to determine how geographic areas are divided into territories by the insurers and provide a means of following how the insurers are handling classification.

The Illinois state commissioner's office has recently completed a study that is the first consistent attempt to calculate statistically significant relationships between the measures of structure and the measures of behaviour. Data on monitoring measures produced by the N.A.I.C. have not attempted to standardize those measures with respect to economic factors, nor have they attempted to recognize the relative performance of states.

2. The N.A.I.C. Monitoring Data

While none of the individual jurisdictions in the United States are actively monitoring open competition rate regulation in a systematic and comprehensive fashion¹, the N.A.I.C. has continued to experiment with and develop monitoring measures. In 1976 the N.A.I.C. Regulatory Information Subcommittee published the results of its efforts to calculate a variety of performance and structural indicators. In a 1977 supplement to this study, entry and exit data were developed and in June of 1978 the subcommittee reported on its attempts to develop measures of pricing behaviour. A useful indicator of the direction in the N.A.I.C. thinking on open competition rate regulation is the fact that this subcommittee changed its name in 1978 to the Competition Subcommittee.

Principal Indicators

The principal indicators by which the existence of competitive forces in the market place is to be monitored in the N.A.I.C. approach include:

1. The State of New York Insurance Department produces a biennial report to the Governor which examines various aspects of insurance markets in New York and comments on some of the indicators of competitive behaviour discussed below.

Performance Indicators:

1. Property and liability insurance profitability, all lines country-wide.
2. Comparison of inter-industry rates of return.
3. Operating profit by line by state.
4. Variation of rates.
5. Independence in pricing.
6. Price changes per company per year.

Structural Indicators:

1. Concentration ratios by line by state.
2. Market share ranking by line by state.
3. Entries and exits.

Performance Measures

The principal measures of performance suggested by the N.A.I.C. study relate to profitability and pricing. Measurement of profitability is important because economic theory suggests that the existence of abnormally high profits in an industry will attract new entrants to the market and encourage competition for a share of this profitable business. Price measures are important since price is the focus of competitive forces in the model of perfect competition and the most obvious variable to monitor in actual markets. The study suggests several measures of both profitability and price.

(a) Profitability Measures: Methodology

Three basic questions will need to be answered in order to accomplish the monitoring task with respect to profitability measures. First, what is the appropriate time period over which the profit measure should be monitored? Second, what constitutes excess profit? Finally, how is profit for measurement to be measured? Economic theory suggests that the appropriate time period is the 'long run', that period of time in which firms can enter and leave the industry. The N.A.I.C. study suggests that this period of time is relatively short in the insurance industry. However the volatility of underwriting results and capital gains indicates to the N.A.I.C. observers that a period of three to ten years would be appropriate. The definition of normal and excessive profits is left to the regulator on the grounds that the extensive literature and debate on profits in the insurance industry in the United States has not provided an answer. Finally the measure of profit is based on data from the N.A.I.C. Statistical Reporting system which provides both on all lines, county-wide measure of profitability and uniform by line by state measures of profitability.

In the N.A.I.C. study, return on net worth and return on sales ratios have been calculated with two measures of income, one excluding capital gains on the grounds that short-term volatility in capital gains would obscure

the actual insurance operating results. While the report recognizes that the difficulties in measuring profits preclude precise and specific judgments, it suggests that since, on the basis of data for the 1971-1976 period, rates of return in the insurance industry are lower than in non-insurance industries, the overall profitability measures "do not provide evidence of a lack of workable competition".

The report also provides data on profitability by line by state, although for practical reasons the profitability measure is restricted to return on sales. The report suggests that on the basis of the observed relationship between the industry-wide measures of return on net worth and return on sales, a reasonable range of rates of return on net sales could be determined and applied to the by line by state average figures "to obtain a general sense as to whether the profit levels suggest the presence or absence of workable competition".

The comparisons of rates of return suggested in the study are based on industry-wide profitability as opposed to individual firm profitability. In the normal course of economic activity some firms will be more profitable than others even in the most competitive of markets. The emphasis on individual firm profitability that derives from the concern for solvency is quite separate from the focus on industry-wide profitability in the assessment of whether a market is workably competitive.

(b) Price Measures

The second group of performance measures focuses on prices as reflected in premiums. Whereas the data on profitability and concentration were calculated by state, the data on prices have been provided for only two states as pilot studies. This approach was in keeping with the developmental nature of the study and the need "to provide illustrative data and comments as to the types of data and factors which a state may consider in evaluating competition therein". The aspects of pricing performance that the study measures are:

- price levels
- price variation
- pricing independence
- frequency of price change.

(c) Price Levels

Data on price levels provide little information about the presence of workable competition in a market. However, when compared with loss cost experience, changes in price levels would indicate something about competitiveness in the market. A significant improvement over time in loss cost experience which did not precipitate a reduction in premiums, other factors remaining the same, would suggest that the market was not workably

competitive. Increases in costs that were followed by proportionately larger increases in prices would also be indicative of the weakness of competitive forces. The study points out that the data available is limited and the time period covered by the available data is short. Any conclusions drawn on the basis of this data would be tentative and a longer time series would be needed to determine if lags exist between changes in costs and changes in price.

(d) Price Variation

The variation in prices has also been measured although it is not clear how variation is to be interpreted as an indicator of the presence of workable competition. Economic theory suggests that over the long term competition will result in a uniform or nearly uniform price for a homogenous product in a given market. This would suggest that a lack of price variation would be indicative of competitive forces at work. In the world of functioning markets, however, the dynamics of market behaviour suggest that there would be noticeable variation in prices in the short run. In the absence of collusion one would expect that in a competitive market there would be a trend towards uniformity in price. The fact that, in a non-competitive economic model, a single uniform price also results, means that evidence of non-collusive behaviour as determined by structural measures and an examination of market conduct will be an important consideration in assessing the price variability measures.

The variability measures calculated in the N.A.I.C. study are coefficients of variation and measures of price dispersion. The coefficients of variation give an indication of how different the typical rate is from the average rate. These coefficients are calculated by dividing the standard deviation of the rates, a statistical measure of the absolute variation in the rates, by the average rate. The larger the resulting number the greater the variability in pricing that exists.

The N.A.I.C. study points out that price variability can result from inherent frictions in the rate setting system, differences in the products for which rates are being compared and a lack of consumer knowledge of price differences which would lead to competitive shopping. The first source of variation is an example of market dynamics at work while the second and third reflect violations of two of the assumptions of perfectly competitive markets.

Market dynamics and the complexity of the rate changing process itself suggest that there "will be a lack of uniformity in rates even in a highly competitive insurance market". It takes time for firms to recognize and react to changing market conditions. Different firms will adjust prices with different degrees of efficiency and on the basis of different evaluations of the significance and extent of changed market conditions. Thus the rates es-

tablished for similar products can vary significantly between competing firms at a given point in time even though the pressure of competition encourages a trend towards more uniform rates over time.

The second and third sources of variation arise in actual markets because product differences do exist, a violation of the assumption of homogeneous goods in the perfectly competitive market, and consumers do not have perfect knowledge of the prices and characteristics of alternatives. Measures of variability can minimize the impact of non-homogeneity by excluding the writings of substandard risks and considering the rates on the most common coverage. There is no obvious way of minimizing the impact of lack of perfect consumer knowledge on price variability. Clearly the interpretation of price variation measures will have to be carried out in conjunction with the assessment of other structure and performance measures and will require care.

(e) Pricing Independence

Independence in pricing was measured by calculating the price dispersion above and below the average state-wide rate in percentage terms for private passenger automobile and physical damage coverages. The market shares of the companies included in the price data were included in the tables of price dispersion in order to provide some indication of the significance of the dispersion.

(f) Frequency of Price Change

Finally the frequency of price changes was calculated as an additional measure of competitiveness in the market. The assumption underlying the usefulness of the frequency measure is that the more competitive the market, the more often prices will react to changes in underlying market conditions. In less competitive markets, for example, an improvement in loss experience that suggests a reduction in premiums might be ignored so that companies can benefit from new higher profit margins at existing rates. If at some point loss experience again deteriorates, premium levels would remain unchanged again since they were previously adequate to cover that loss experience. Thus there would have been no price change even though market conditions had changed twice. In a more competitive market the change in loss experience would have resulted in price changes as market participants competed for new higher profits. The frequency of price changes then will depend to some degree on the presence of competition in the market place although there is not yet a sufficient history of data or interpretational experience to say what frequency will be the critical one.

The N.A.I.C. study does not "establish any guidelines as to what levels, variations and frequencies are indicative of the workably competitive market". The establishment of these guidelines will require an extension in

the time horizon of the data base, and review and analysis of these data in relationship with the data pertaining to the other tests of workable competition.

Structural Measures

As stated above the monitoring mechanism looks at market structure in an effort to determine whether or not the structural characteristics of a particular market are such as to allow the beneficial results of competition to be realized. The question is the degree to which the existing market structure approximates that hypothesized in the theory of perfect competition.

Structural measures concern the size, the number and the dispersion of firms and attempt "to indicate whether or not there are enough firms in the market so that no one firm is able to independently influence the price of the product". In other words the structural tests which are based on concentration ratios, market share rankings and measures of entry and exit are primarily designed to enable the monitoring agency to make some judgment as to whether or not firms are price takers in the market place. If an analysis of these structural measures reveals that to a significant degree the firms operating in the market place are not price takers, but can effectively influence the price of the product, then it can be said that competition in the market place is being impaired.

(a) Conceptual Problems

In order that these structural measures may be calculated, several conceptual problems need to be resolved. The model of perfect competition assumes that the product offered in the market place is homogenous. This simply means that consumers are unable or unwilling to differentiate between different units of the product regardless who produces it. In practice there is some question as to what constitutes a homogenous product. The N.A.I.C. report on monitoring measures has concluded that the product will be defined in accordance with annual statement line of business since the risk coverages included are more or less homogenous.

Another conceptual difficulty concerns the proper definition of a firm. The N.A.I.C. adopted the rule that an insurance firm is any company or group of companies under common management, ownership or control.

A third conceptual difficulty involves the definition of the geographic market in which the various firms operate. The subcommittee report points out that the geographical definition of the market is different from the consumer's point of view than it is from the seller's point of view. From the consumer's point of view, the market may be defined geographically as the individual rating territory in which he lives. From the seller's point of view, the market area would encompass a range of rating territories. From the institutional point of view, a licenced insurer in a state is permitted to under-

write risks in any of the rating territories in that state. As a result, the study has concluded that the geographical market be defined as state-wide.

(b) Concentration

The final conceptual problem concerns the measurement of size. Sales as measured by earned premium were selected as the appropriate indicator of size. The sales data were used to calculate concentration ratios which were simply the sum of the market shares for a specified number of firms. Following established practice in the study of concentration in other industries, the N.A.I.C. subcommittee calculated concentration ratios on a four firm, eight firm, and twenty firm basis.

The study warns that "great care must be taken in the interpretation of these concentration ratios". In the first place, critical values of these concentration ratios have not been established. This is the case because the history of the data is too short for clear conclusions about critical values to be made. In addition, there is good reason to suspect that the concentration ratios contained in the tables appended to the N.A.I.C. study are higher than the ratios that have been calculated for industry groups in other concentration studies. This is so because of the narrower definition of the market used in calculating these ratios when compared to the market definition used in the study of concentration in other industries.

The study suggests that there is a critical degree of concentration beyond which increasing concentration would suggest that there is a strong possibility that the assumptions of the competitive market are being violated. The question remains as to what the degree of concentration is that would lead one to this conclusion. The N.A.I.C. has decided on the basis of studies conducted by Arthur B. Little Inc. and others that "discretionary pricing power becomes quite severely limited when the top four firms in an industry control less than half, and the top eight firms less than 70% of the industry's output".

While this could serve as a rough rule of thumb, it is not clear that it captures the critical value of the concentration ratio beyond which competition can be said to be impaired. In the first place, the calculation of concentration ratios by line of coverage by state severely limits the size of the market being monitored. It is quite possible that this narrow definition of the geographical market could lead to relatively high concentration ratios even though competition is present.

This suggests that while concentration ratios are an important measure of structure taken by themselves, they are not adequate to meet the needs of monitoring the state of competitive behaviour. In fact, they need to be supplemented by other monitoring measures such as profitability and price variation. It is also important to note that a period of time will be required in

which the review and analysis of concentration data will suggest critical values of the concentration ratios.

(c) Market Share

As a complement to the calculated concentration ratios the N.A.I.C. has prepared tables which illustrate the market shares of the top 30 firms for each line of business in each state. The purpose of these tables is to allow the monitoring agent to determine whether or not there is viable competition in the market given the degree of concentration. For example, frequent changes in the ranking and the market share of the market leaders would suggest that competition was more vigorous than if particular firms continued to dominate the market over a period of time with little change in their relative importance. In addition, it is possible that a particular market might exhibit a high level of concentration with four or five firms controlling a major proportion of the underwriting and still have an acceptable level of competition. One indication of this would be the degree to which the leading firms were equal in size. The table of market shares for the top 30 firms would be one way of assessing whether or not this was true.

(d) Entry and Exit

A second structural test of workable competition developed by the N.A.I.C. is a set of measures relating to entry and exit from the marketplace. In the theory of competitive markets, there are no barriers to prevent firms from entering or leaving the market place in response to high profit levels in the first case and insufficient rates of return in the second. Since the freedom to enter and leave markets is an important requirement in the theory of competitive markets for an efficient allocation of resources, it is necessary to examine the entry and exit pattern in monitored markets if an assessment of whether or not competition is workable is to be made. There are difficulties with the concept of exit and entry in insurance markets since the requirements for solvency dictate that firms should not be completely free to leave the market.

Nevertheless, the N.A.I.C. has concluded that it is possible to calculate measures relating to entry and exit that can be used for the purposes of monitoring workable competition. The N.A.I.C. preliminary report rejects changes in the number of insurers licenced to underwrite in a jurisdiction as a measure of entry and exit because licenced firms may not actually write business or the amount of business they do write in a market may be minuscule. Thus in the report "a firm is said to have entered a market if its market share rose from less than .05% to .05% or greater. Conversely, an exit is similarly defined in the opposite direction. Mergers and insolvencies are counted, only if they involve firms whose market share was .05% or greater in the previous year".

The same qualifications of the measures of entry and exit can be made as were made with respect to concentration ratios. There are as yet no critical values which can be applied to the entry and exit data in order to ascertain automatically whether or not a significant degree of workable competition exists in the market. As well, the entry and exit measures would have to be applied in conjunction with an assessment of other monitoring measures. The difficulties are compounded with entry and exit data since the N.A.I.C. has only been able to calculate measures for 1976 and 1977 and there is no historical data base on entry and exit at this time to make comparisons over time.

Again the monitoring of entry and exit measures will have to be carried on in conjunction with the monitoring of profit levels. This follows because the expectation is that rising profit levels will encourage entries and declining profit levels will result in exits. On a line by line basis then, one would expect that there would be some co-relation between profit behaviour by line and entry and exits. The entry and exit measures while admittedly experimental are innovative approaches in the attempt to monitor this aspect of market structure.

Entry and exit data will have to be considered in conjunction with data on changing market shares. It is possible that competitive behaviour in response to above average industry profits could lead to an expansion of the market shares of existing firms rather than an encouragement of new entrants into the market place.

3. Summary

Clearly monitoring market behaviour to determine whether or not a market is workably competitive will be a complex process in which judgmental assessment will play a key role. There is no one, unambiguous, all encompassing measure of workable competition. Rather at this point there are a variety of approaches that have numerical content that must be treated with care. Each of these approaches has something to say about the presence and extent of competition when it is considered in conjunction with the other measures. The usefulness of each of these measures will improve over time as the data base becomes larger and the trends and variability in the data become more obvious. One of the principal requirements then for developing a monitoring mechanism is a consistent data base that covers a sufficiently long period of time.

A second major requirement is a person to act as an evaluator, who has significant insurance industry experience combined with extensive knowledge of the economic theory of markets. The judgmental assessment of the existence of workable competition will require the application of this sort of expertise.

D. MONITORING MARKET BEHAVIOUR IN ONTARIO

The Department of Insurance has provided a short note on the extent to which competition is monitored in Ontario. The extent to which competition is monitored is limited in their view by the lack of a complete theory of "acceptable competition", a shortage of manpower and data processing resources and a desire to limit the reporting burdens placed on firms in the industry. The rest of this section describes the current practice with respect to automobile, homeowner's and life insurance, as contained in that note.

1. Automobile Insurance

"A survey is conducted late each year in which all companies quote premiums for all territories for a mature driver and a 21 year old driver. Quotations are for liability only and full coverage. The rates requested are intended to reflect the current price for an average situation. Some caution has to be exercised in using the data to obtain year on year changes experienced by the same person.

The data are processed to obtain average prices in each territory, weighted by Ontario market shares for each company, and measures of the dispersion of prices.

The results are examined to detect clustering about the average price or wide price deviation; adherence to I.A.O. recommended rates by I.A.O. companies and changes in ranking from year to year. We interpret diversity of price and changes in ranking as evidence of competition. At times the price spread will narrow but as long as this is a transient phenomenon we assume competitive pricing still exists.

Obviously much more information could be obtained for more driver classifications but a move in this direction will substantially increase the reporting burden for insurers and would require expenditure on additional processing equipment in the Department of Insurance.

The existence of a standard automobile contract in Ontario facilitates price comparison in that ostensibly an identical product is being priced. In practice quality of performance by the insurer is an important factor.

The complaints officers currently handle approximately 10,000 telephone queries each year concerning all forms of insurance, of which 2,000 develop to written complaints. The majority of these complaints concern automobile insurance. The department has run a pilot study classifying complaints and produced a ranking of companies relating complaints to premium volume. The pilot study achieves two purposes:

- (a) Companies with a persistently high complaint level can be informed of their high ranking. Feedback is often sufficient to enable a company to

improve its operation. Failure to respond by the insurer would provide evidence for more drastic action.

- (b) Particular problem areas can be highlighted. Thus, competitive problems with special risks such as dump trucks or taxis or with adequate capacity in certain territories can be identified. Usually corrective action can be initiated given convincing evidence of the extent of the problem."

2. Homeowner's Insurance

"In the case of homeowner's insurance, a standard policy form is not mandatory. While this permits innovation it also hampers monitoring of price competition.

The Department of Insurance does not at this time routinely monitor homeowners insurance rates. Complaints tend to indicate vigorous competition for adequately insured risks in most areas. However, market problems exist with high risk areas or where the amount of insurance is far below property value. The problem arises partly due to poor public relations by the industry which has failed to explain the problem of underinsurance and partly due to overly simplified rate structures used by companies. Some difficulty is also experienced verifying that the pricing of package policies is still competitive with the price of component parts.

Competition monitoring in this area appears to be a more subtle problem than in the case of automobile insurance, and may require development of a standard policy form with a basic coverage and options of identical form. The insurance to value problem will also have to be dealt with."

3. Life Insurance

"The Department has conducted its own studies of price comparison methods. It is doubtful whether any simple method can be used for price competition monitoring purposes."

4. Data Requirements

Further discussions with representatives of the Department of Insurance suggested that a significant data study is needed in order to develop a data reporting system that would provide for the information requirements of monitoring the effectiveness of competition. The objective of this study would be to recommend ways in which existing data reporting systems could be modified to accommodate the needs of the monitoring mechanism. It is likely that the study could be coincident with other data reviews that are currently underway within the Department.

Several areas of investigation were suggested in these discussions that

would provide a starting point for a more complete study design. The first is the question of differentiating between calendar year and policy year in data reporting. One aspect of this issue according to Department representatives is that claims reserves set up in one calendar year may be affected by claims from different policy years. Financial reports for a given calendar year are therefore not an accurate reflection of that year's underwriting activity. It was suggested that reserve change reporting should differentiate between policy year and calendar year by line.

A second issue concerns the need to have a separation between data for commercial lines and personal lines. In principle the commercial lines and personal lines should be independently priced but there is no way of monitoring whether this is so because of the aggregation of data. Methods of data reporting that distinguish between commercial and personal lines would be part of the data study.

A third issue involves the need to allocate expenses by line and in some cases by Province. Any monitoring of cost changes would require this allocation.

5. Summary

Clearly monitoring activity in Ontario is at an early stage of development. This is understandable in the absence of specific legislation which would encourage a more thorough approach to monitoring. The focus in Ontario's supervision of the insurance industry has been on solvency and, as the note from the Office of the Superintendent suggests, the data required for more extensive monitoring are not regularly reported.

The Department's requirement for a theory of "acceptable competition" may be satisfied with the concept of workable competition discussed in this paper. The performance and structural measures suggested by workable competition would provide a framework within which the existing price monitoring carried out by the Department could be placed. The assessment of measures other than price would permit a much broader monitoring of the extent of workable competition in Ontario's insurance markets.

The current monitoring of automobile insurance rates carried on by the Department of Insurance represents the beginnings of a more extensive monitoring system. The concepts of workable competition discussed above and the preliminary calculations of monitoring measures carried out by the N.A.I.C. suggest the directions in which this monitoring system could develop. The performance and structural measures that comprise such a system are clear; their calculation for Ontario can probably be made once revisions to existing data reporting systems are made.

APPENDIX K
(referred to in Chapter 13)

**LEGAL OPINION ON SECTIONS 18 AND 90 OF
THE INSURANCE ACT**

January 29, 1979

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Dear Mr. Breithaupt:

I have been requested . . . to provide the Committee with an opinion as to the meaning of and relationship between sections 18 and 90 of The Insurance Act, R.S.O. 1970, c. 224, as amended. The sections are as follows:

Section 18 The Superintendent may publish from time to time notices, reports, correspondence, results of hearings, decisions and any other matter considered by the Superintendent to be in the public interest.

Section 90 Any information, document, record, statement or thing made or disclosed to the Superintendent concerning a person licensed or applying for licence under this Act is absolutely privileged and shall not be used as evidence in any action or proceeding in any court brought by or on behalf of such person.

On their face, the two sections appear to conflict in that while section 90 provides that certain information is absolutely privileged, section 18 allows the Superintendent to publish material which he considers to be in the public interest. There is nothing in the balance of The Insurance Act which gives any indication as to the meaning of these sections; nor is there any case law dealing with the interpretation of the sections.

Section 90 is historically the older of the two provisions. It first appeared in The Insurance Act, 1934, S.O. 1934, c. 22, section 6, and has appeared consistently in each version of The Insurance Act thereafter. Section 18 was first introduced by The Insurance Amendment Act, 1970, S.O. 1970, c. 134, section 3. I have been unable to find any specific reference to section 18 in the Debates of the Legislative Assembly. However, the 1970

amending Act, by section 9, authorized insurers to sell variable contracts based on segregated funds. Prior to 1970, these contracts had been considered to be subject to the control of the Ontario Securities Commission. In 1969, however, the Ontario Securities Commission exempted these contracts from its regulation. It was stated in the Legislative Assembly that it was intended that the Superintendent of Insurance would henceforth regulate the sale of variable insurance contracts (Hansard, November 17, 1969, page 8, 441). It may be that section 18 was introduced at the same time to give the Superintendent of Insurance the same powers of publication as the Ontario Securities Commission possessed under The Securities Act.

Section 90, which confers an absolute privilege on certain information disclosed to the Superintendent, appears to be based on the principle that reports made by citizens to government officials under compulsion of law should be privileged. The underlying policy behind this principle is that in many instances government requires information that can only be obtained from the person himself whose affairs are desired to be known by the government. An attempt to obtain it by compulsion alone may well be ineffective. Therefore, it is expedient for the government to promise to cloak the information in some special degree of secrecy in exchange for ready and truthful disclosure (Wigmore, Vol. VIII, section 2377). The extent of the privilege conferred must be determined from an examination of the wording of the statute. In some instances, the privilege only bars extra-judicial disclosure of the information, whereas in other instances, it forbids disclosure even in court. In the latter case, the privilege may either extend to allow a citizen to refuse to produce a report or it may prevent anyone including the citizen from producing that report. In my opinion, section 90 falls within the latter category and absolutely prohibits any person, including the Superintendent or the insurer, from disclosing any information, document, record, statement or thing made or disclosed to the Superintendent concerning a person licensed or applying for a licence under the Act, and prevents that information from being used in evidence in any action or proceeding brought by or on behalf of such person.

Since section 90 is a general prohibition, in my opinion it overrides section 18 in so far as the two provisions conflict. It is not entirely clear whether the two provisions, in fact, conflict, since they seem to refer to different types of information. Section 18 refers to "notices, reports, correspondence, results of hearings, decisions and any other matter considered by the Superintendent to be in the public interest"; whereas section 90 refers to "information, document, record, statement or thing made or disclosed to the Superintendent". Furthermore, section 18 appears in Part I of the Act entitled "Superintendent and His Duties", and section 90 appears in Part II of the Act entitled "General Provisions Applicable to Insurers" and subtitled "General". Moreover, it appears that section 90 deals specifically

with the question of privilege and, therefore, may be said to override the more general provisions of section 18.

In any event, section 18 is discretionary in its language in that it provides that the Superintendent may publish certain material if he considers it to be in the public interest. Since the Superintendent is prevented from disclosing the information referred to in section 90, it is unlikely that he could consider publication of that information to be in the public interest. However, if section 18 is to be read subject to section 90, it may be advisable to amend section 18 to specifically provide that it is subject to section 90.

Yours very truly,

“SHELLEY ROBB”

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Counsel

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